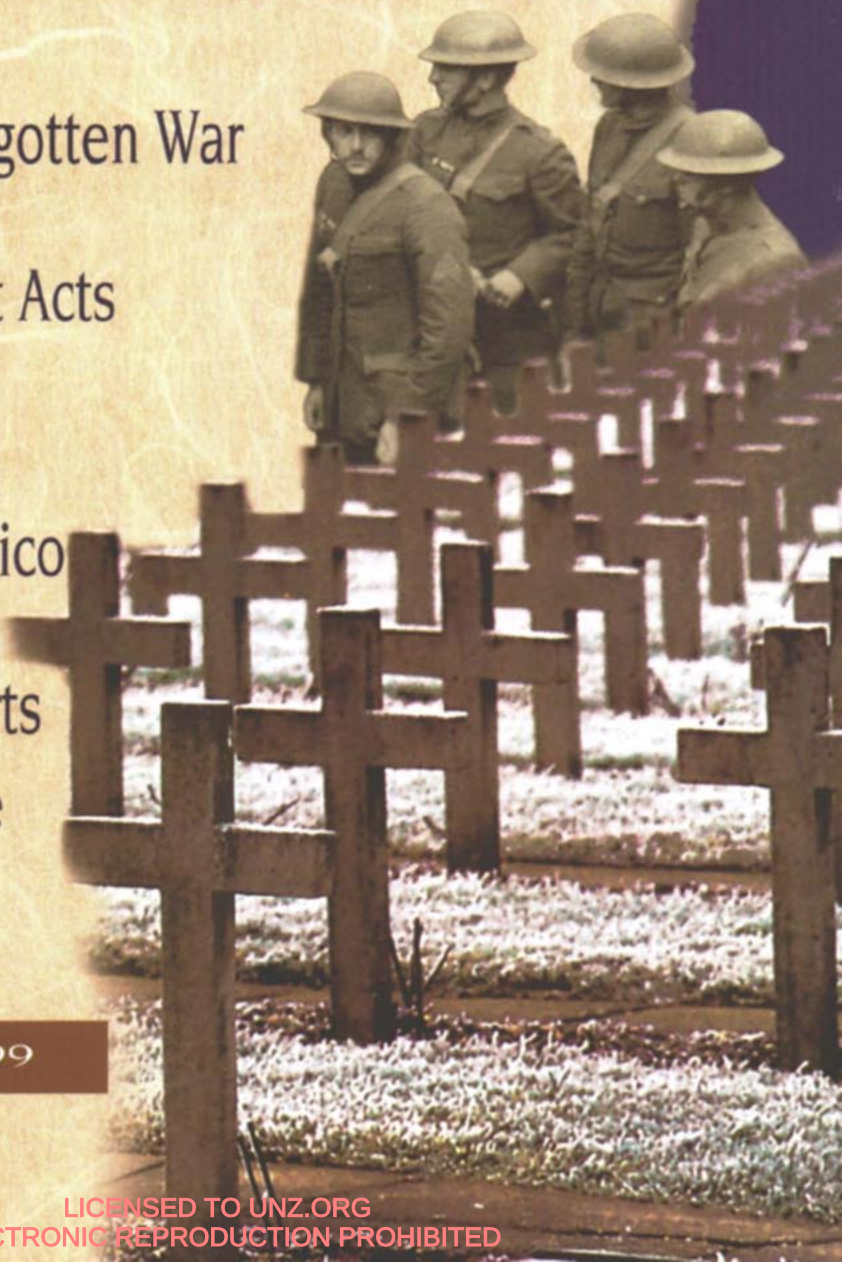
# THE FREEMAN

Ideas On Liberty



- America's Forgotten War
- The Bully that Acts Like a Hero
- Mises on Mexico
- Russell Roberts on Free Trade

MARCH 1999

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# 1999 FEE Undergraduate Seminar
## *Where Liberty and Learning Meet*

"Thank you for having me as a guest at the fabulous FEE institution. It is truly a bastion of freedom and liberty that helps mold individuals' minds to become stronger with economic understanding. I thoroughly enjoyed the lectures that were given at the seminar; they met my highest expectations!!"
—NOEL SAWATZKY, The Citadel, Attendee at March, 1998 Seminar

FEE's annual Undergraduate Seminar will take place March 18 to March 20, 1999. This two-and-one-half day seminar is designed to introduce college undergraduates to the ideas and principles of free-market economics and classical-liberal philosophy. ☆

Students from across the country and from around the world join us to discuss and debate the ethical and economic advantages of free-markets, private-property rights, and limited government. Speakers will challenge students to consider why freedom is important in their lives.

The seminar begins with the Second Annual John Anthony Krogdahl Memorial Lecture, by Bruce Yandle of Clemson University, on Thursday evening. On Friday and Saturday students will participate in four one-hour lectures. Discussion sections will follow.

Our selection process is competitive. Students must complete an application form and a short essay. FEE hosts those students selected to participate in the seminar. Students are housed in FEE's dormitories. Meals from Thursday evening through Sunday morning are provided. Books and other reading material are also provided by FEE.

**Students are responsible for their travel expenses only.**

If you would like to apply for this seminar, or if you would like to receive a nomination form for a student you know, please contact Karol Boudreaux, FEE, 30 South Broadway, Irvington-on-Hudson, NY 10533, (914) 591-7230 (office), (914) 591-8910 (fax), or kboudreaux@fee.org.

**☆ You can help promote liberty by sponsoring a student at this seminar. For $400.00 you can cover the costs of one student's participation. Please note on your check that you are sponsoring a student or call or fax a credit card contribution. Thank you for your help!**

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Ideas On Liberty
March 1999 Vol. 49, No. 3

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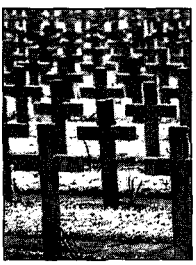

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*Cover image of World War I soldiers courtesy of Lebanon County (Pa.) Historical Society.*

PERSPECTIVE

## Life Imitates Gilbert

In jolly old England Queen Elizabeth II has stripped the hereditary peers of their parliamentary power in the House of Lords. The act constitutes the leveling of the dukes, earls, marquesses, viscounts, and barons, some of whose titles go back to William the Conqueror, Duke of Normandy, who subdued England in 1066 and became William I.

For devotees of another William—William Schwenck Gilbert (1836–1911)—this all has a familiar ring. Gilbert, of course, was the liberal spirit and comic librettist who with Arthur Seymour Sullivan composed the greatest collaborative effort by Englishmen ever—Monty Python, Lennon and McCartney, and Churchill and Bomber Harris included. Mencken called Gilbert "even above Mark Twain, the merrymaker of his generation."

Gilbert's arsenal of jibe and joke and quip and crank was reserved almost exclusively for men of rank. As his alter ego, Jack Point, put it in *The Yeomen of the Guard*:

> At peer or prince—at prince or peer,
> I aim my shaft and know no fear!

Gilbert played with the idea of radical change in the House of Lords in his and Sullivan's opera *Iolanthe*. In synopsis, a band of fairies casts a spell on the Lords for coming between a young shepherd and his betrothed, Phyllis. Magically, Strephon is seated in Parliament and "carries every bill he chooses." But the fairies go further. Speaks the Fairy Queen:

> Peers shall teem in Christendom,
> And a Duke's exalted station
> Be attainable by Com-
> Petitive Examination!

Gilbert had no more mercy for the Peers than the Fairy Queen did. His Lord Mountararat explains that an undistinguished group of noblemen had never barred England from greatness in the past.

> When Wellington thrashed Bonaparte,
> As every child can tell,



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The House of Peers, throughout the war,
Did nothing in particular,
And did it very well:
Yet Britain set the world ablaze
In good King George's glorious days!

Even a lowly sentry knew the score. Private Willis points out that members of Parliament, "if they've a brain and cerebellum, too," leave their brains outside Westminster Hall "and vote just as their leaders tell 'em to." Not that that's a bad thing:

But then the prospect of a lot
Of dull M.P.'s in close proximity,
All thinking for themselves, is what
No man can face with equanimity.

All ends well, of course. Each Lord marries a fairy—happily exchanging House of Peers for House of Peris.

No moral here, just an observation: Gilbert saw hereditary rank, and government in general, as something to be knocked down a notch. It's good to see the world catching up with him.

* * *

It cannot be said too many times: Property is the key to liberty, justice, and prosperity. Which is why Tom Bethell's new book, *The Noblest Triumph*, is such a welcome addition to the literature of freedom. In the excerpt reprinted herein Bethell examines the crucial connection between property and justice.

Speaking of justice, more than a few people think the gap between what corporate CEOs and workers are paid is a scandal. The gap is real; the injustice is illusory, as Charles Baird demonstrates.

Since the atrocious murder of a young homosexual man in Wyoming last year, the push for a national "hate crimes" law has been renewed with vigor. Not so fast, writes Melissa Suarez, who finds good reasons to be wary about well-meaning legislation aimed at states of mind.

In 1943 the great classical liberal Ludwig von Mises wrote a book about Mexico's economic problems. The manuscript lay forgotten in his papers until our own Bettina Bien Greaves found it in 1997. It was translated into Spanish and published in Mexico. Eduardo Turrent discusses the significance of Mises's work.

The cost of government regulation is not merely the money spent but the untold things we must do without because innovation is stifled. Eric Nolte provides a glimpse of what we would be enjoying were the federal government not regulating aviation.

The Western idea of limiting government power—and clearing a large space for individual creativity—is the product of a long, complex, and unplanned historical process. Tom Palmer takes us on the consequential journey from servitude to freedom and back.

Everyone knows that Americans save too little. Too few know why. John Hood puts the idea of saving into historical perspective and comes to some provocative conclusions.

Remember the last time the government declared some problem solved and disbanded the agency charged with solving it? Neither do we. Harold Jones, Jr., says it's not our memory that is failing.

To win someone over to the freedom philosophy, it helps to connect with the intuitions he already possesses. James Otteson sets out a game plan for persuading philosophers that liberty is indivisible. It's not just for philosophers.

In columns this month, Lawrence Reed inveighs against "living wage" legislation, Dwight Lee expounds on opportunity costs, Doug Bandow revisits the stupidest war of the twentieth century, Mark Skousen ponders the millennium bug, and Russell Roberts, our newest contributor to "The Pursuit of Happiness," looks for the unseen. Lawrence White mulls over Jagdish Bhagwati's nod to capital controls, and counters, "It Just Ain't So."

Books that come under review this month deal with the war on tobacco, the ten "worst" presidents, the post-communist world, judicial corruption, and Paul Johnson's history of America.

—SHELDON RICHMAN



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## Asia Needs Capital Controls?

# It Just Ain't So!

Citing the East Asian financial crisis, the well-known trade economist Jagdish Bhagwati has recently given support to retaining capital controls in developing countries. In essays in *Foreign Affairs* and more recently, the *Wall Street Journal* ("Yes to Free Trade, Maybe to Capital Controls"), Bhagwati cautions that the "overwhelmingly powerful" case for free trade does not imply an equally strong case for free capital flows because there is "a unique downside to a policy of free capital flows." The downside is that "capital flows are subject to what the economic historian Charles Kindleberger of MIT has called panics, manias, and crashes."

Bhagwati contends, against the well-known argument that speculators who bet against fundamentally strong economies will be disciplined by losses in the marketplace, that "the unfortunate fact is that speculation can be self-justifying." That is, by abandoning an economy, investors can themselves weaken it. He asks rhetorically: "Is this not what most likely happened when, out of panic, investors fled from what they perceived as weakened Asian economies, weakening them when they were originally strong?"

No, this is not what most likely happened. Blaming investors for the fall of the Thai bhat or the Indonesian rupiah is like blaming umbrella-carriers for the fall of rain. Capital flows can of course be volatile, but attributing a shift in the behavior of independent and calculating investors to a self-validating "panic" or "mania" is at best an explanation of last resort. A large speculative attack on a central bank to get foreign currency before the fixed exchange rate collapses—like an old-fashioned run on a deposit bank to get cash before it is gone—*could in principle* be self-validating, because a central bank with fractional reserves will eventually run out of foreign currency reserves and be forced to devalue.

But *in practice* the speculative attacks we witness are not of this self-validating sort. Just as the historical evidence indicates that nineteenth-century runs on deposit banks were generally triggered by bad news indicating the likely insolvency of those specific banks, speculative attacks on fixed exchange rates are generally triggered by bad news about economic fundamentals. The idea that unrestricted financial markets are prone to manias or bubbles is founded on historical myth, as my colleague George Selgin has shown by re-examining the historical episodes cited by Kindleberger and others as supposed examples of bank-lending manias (*Journal of Financial Services Research*, August 1992).

At its root, the fall of their currencies' exchange values, and the subsequent reversal of capital flows to Thailand, Indonesia, the Philippines, and Malaysia, were votes of no confidence in the exchange-rate and monetary policies of their governments. It is of course a challenge to explain the exact timing and size of the dramatic shifts observed. But if some sort of pure self-validating mania or panic had been afoot in the region, it would be hard to explain why Hong Kong, Singapore, and Taiwan were spared devaluations.

The countries that crashed were basically those where expansionary monetary policy was on a collision course with the supposed commitment to a fixed exchange rate against the U.S. dollar. As basic exchange-rate theory tells us, a fixed exchange rate between the local currency and the dollar cannot be maintained unless the creation of local money is limited to the amounts consistent with holding the local inflation rate down to the U.S. dollar inflation rate.



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To generalize rather sweepingly, large amounts of capital had flowed in during the 1990s because, if the exchange rates really did remain fixed, high real returns were available from nominal interest rates well above U.S. dollar rates. Local commercial banks became loaded with poor-quality loans, in some degree because of government intervention or corruption in allocating loans, and in some degree because of excessively risky lending encouraged by implicit government guarantees to the banks. The nonperforming loans of Indonesia's banks, for example, reached more than a quarter of total loans before 1996. International investors finally lost faith because it became clear that the central banks, when forced to choose, would print money to keep the banks afloat rather than exercise the monetary restraint necessary to maintain the fixed exchange rate.

The succession of crises in several southeast Asian countries, beginning with Thailand, has led many commentators to speak of a "contagion" by which crisis spreads from one country to another. The solution supposedly lies in global crisis management by the IMF. But as Anna J. Schwartz has noted in the *Cato Journal* (Winter 1998), "it was not contagion from Thailand, however, that made the countries vulnerable to a financial crisis. They were vulnerable because of their home-grown economic problems. Capital flight from countries with similar unsustainable policies is not evidence of contagion."

Capital flight imposes a very useful, if sometimes harsh, discipline. As former Citicorp CEO Walter Wriston notes (in an interview with *Wired*), the flow of short-term capital "functions as a plebiscite" on a government's economic policy. When a change in policy is observed, "by the end of the day, the market will have conducted a referendum reflecting the collective wisdom of people all around the world on what they think of [the new] economic policies. If your economic policies are lousy, the market will punish you instantly." Wriston adds: "I'm in favor of this kind of economic democracy. There's nothing you can do to change it, except do right."

Governments, of course, deeply resent the discipline that the market imposes. In an interview with *Business Week* earlier this year, Malaysian Prime Minister Mahathir Mohamad blamed the fall of the ringgit on the "herd" mentality of currency traders, likening them to "buffaloes." Even more notoriously, he intimates that "since most of the currency traders are Jewish, and it affects Muslim countries in East Asia, people will think this is a Jewish conspiracy." The Prime Minister imagines that the traders, acting with one mind, can "devalue our currency at will," and that doing so is a riskless get-rich-quick scheme: "When you devalue currency and you short-sell, you make a lot of money. You just push figures on a computer screen, and you make a billion dollars." One marvels that a conspiracy of traders would have waited until 1997 to grab this windfall.

In September, Mahathir announced new restrictions on the convertibility of the ringgit. Among other measures, Malaysian citizens may not take more than small amounts of cash out of the country when they travel abroad. Restrictions of that sort are a nuisance. Still more damaging to prosperity are the restrictions many developing nations impose on large financial outflows. Such capital controls are a cruelly effective investment repellent. No investor wants to bring wealth into an economy where it might become trapped.

It is sad enough when a politician engages in scapegoating and uses it as an excuse to restrict his citizens' freedom to trade in financial contracts. The shame is compounded when a well-meaning economist countenances the herd-mentality view of foreign exchange markets and derives from it a counsel of hesitation in lifting capital controls.

—Lawrence H. White
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# To Each His Due

by Tom Bethell

We lead lives that are so immersed in private property that we easily take its benefits for granted. Some everyday situations give us the opportunity to examine aspects of life without it, however. They permit us to see the great transformation that takes place when a communal arrangement is privatized: efficiency is enhanced, and, far more important, justice itself is routinized. The argument can be illustrated by an apartment building in Washington, D.C., in which the author lived. In one significant respect, the living arrangement resembles Plymouth colony. It is a condominium building of approximately 300 privately owned apartments, bought and sold on the free market. Its total population is perhaps twice as large as that of Plymouth in the 1620s. Owners are assessed a condo fee, arrived at by adding up all expenses jointly incurred, and dividing them by a formula that takes into account the size of the apartments. But for the sake of simplicity, it is here assumed that all units are the same size and that all owners are charged the same condo fee.

The key point is that there are no individual utility meters. The entire building is "master metered" as an undivided whole. The utilities—gas, water, fuel oil, and electricity—make up about one-third of the building's million-dollar annual budget. In the consumption of energy, then, great opportunities for free riding occur.

How are property rights to utilities allocated in the building? All apartment owners (or their tenants, for many units are rented) may use as much water, electricity, and heating oil as they like, without limit. Each owner is then assessed approximately one three-hundredth of the building's total utility bill. In short, it would be a miraculous coincidence if consumption and billing were proportional. In the absence of separate meters, it is very difficult or impossible to achieve such proportionality. This leads directly to the following scenarios. Both are hypothetical, but plausible.

## Meticulous Mary

Consider first Mary, a resident who conscientiously turns off her lights and turns down her thermostat. By the end of the year, she will have reduced the building's overall energy consumption by a small amount, and will personally "recapture" only one three-hundredth of her own saving. She will export to everyone else in the building the benefit of her frugality, but will herself experience the full cost of that frugality (in terms of dimmer lights, hotter summers, and chillier winters). And she will receive a bill only fractionally lower than it would have been if she had been an "energy hog." Let us assume that by her frugality, she saves $150 in utility consumption in the course of a year. That saving is then

*Tom Bethell is the author of* The Noblest Triumph: Property and Prosperity Through the Ages *(St. Martin's Press, 1998), from which this is excerpted with permission of the author.* *Copyright © Tom Bethell.*



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spread over the entire building. As a result, her condo fee—and that of everyone else—will be reduced by 50 cents per annum.

Now we come to Tom, her neighbor (whose resemblance to the author is entirely coincidental). At the supermarket, he buys high-wattage light bulbs, and when he goes out in the evening he carelessly leaves lights on; he turns up the heat in the winter and lets the air conditioner run in the summer. But he will bear only one three-hundredth of the cost. Master-metering and equal division of the bill permits him to saddle everyone else with the consequence of his extravagance, and yet to enjoy the benefits himself. He lives comfortably and makes others pay for it.

Consider what happens when he goes away for a week in August. He briefly considers, in a moment of public-spiritedness, turning his air conditioner off. Then he thinks again: He will have to return to a hot apartment, which will take hours to cool down. So he leaves the unit running. Let us say that the additional cost of this extravagance is $15. Consciously or subconsciously, he may have performed the following calculation: *He* will pay only one three-hundredth of this increment, which is to say five cents. But so will everyone else. His cost of enjoying a cool apartment during the few hours that it would otherwise be hot is a nickel; but everyone else in the building will be unjustly burdened with an additional nickel as well.

Such an arrangement obviously encourages wasteful consumption. Historically, the building's utilities bills have slowly risen, as a percentage of overall expenditures, despite the gradual replacement of inefficient electrical equipment by more modern hardware. When you drive past the building at night, it is a Christmas tree of blazing lights. A spokesman for the Potomac Electric Power Company reports that when individual meters are installed in such buildings, energy consumption usually drops by about 25 percent.

## Separate Meters

The corrective mechanism is readily at hand—separate meters for each apartment. The condo equivalent of separate checks, meters would effectively privatize utilities within the building. Thanks to the walls separating one unit from another, energy *consumption* within the building is already privatized. The role of meters is to permit billing in proportion to consumption. The utilities in the building would then be converted from communal to private property.

But the internal politics of the building make such a remodeling change difficult to carry out. The rewiring is expensive. Admittedly, the energy saving is large enough to permit the cost to be recaptured, perhaps within ten years; but the condo board is reluctant to consider such an expenditure, mainly because the owners of the units (which is to say, the people who elect the board) generally do not consider their investment in the building to be a long-term one. The building's future may not be in their future. Most are planning to sell and move out within a few years, and do not want to finance improvements that may benefit the next generation of occupants more than it will benefit them.

Admittedly, separate meters would increase the value of the building, and the sale price of apartment units would rise commensurately. A persuasive board could possibly prevail on the membership to approve such an expense. In reality, however, the problem of free riding in utilities is virtually invisible. When the great scope for free riding was brought up at a board meeting, one member responded that *less* energy would surely be used in a situation where everybody "took in" everybody else's consumption. He was persuaded otherwise, but this showed that the free-rider problem is not intuitively clear, even to those elected to an office in which they are expected to hold down costs. The inconspicuous nature of the problem, and the visible upfront cost of correcting it, ensures that the issue is perennially postponed. (The problem may eventually be solved by the development of less-expensive metering technology.)

Let us take the logic of communal utilities one stage further. Suppose that board members do conclude that the single-meter system is intolerable. But they resist installing separate meters, let us assume, not just because of the expense, but also because the board mem-

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bers share a philosophical aversion to privatization. They recognize that free riding in utilities results in winners and losers—good people subsidizing bad people—and they decide that this must be corrected. So they declare a goal of "eliminating energy selfishness," and "achieving energy justice" within the building, but without privatizing. How can they do this?

First, they try exhortation. Slogans are posted in elevators and along corridors, circulars are slid under doors, THINK OF OTHERS! TURN OFF LIGHTS WHEN NOT IN USE! A big sign is placed along the roof (as in Soviet Moscow): "Another Building Dedicated to Energy Fairness and Justice!" But within a few months, it is clear that this is not having the desired effect. Tom ignores the signs, Mary is more frugal than ever.

Now the condo board adopts a sterner measure. "Energy monitors" are hired, and they spend their evenings patrolling the corridors and knocking on doors. "Is anyone at home? The weather just turned cooler. Did you turn down your air conditioning?" But after a few months the occupants learn to ignore the knock. Mary has already been doing the right thing. Tom remains unregenerate. Energy consumption remains at its old level.

Then a more drastic step is taken. The energy monitors are provided with apartment keys. It is explained to all occupants that the invasion of privacy will be minimal, because the monitors may enter only after knocking and receiving no reply. That way, they will only enter apartments when people are not at home, "and when people are away, they shouldn't have their lights and air conditioners on anyway." After a while, however, it is discovered that some apartment owners, who are in fact absent, learn to reply to the knock with prerecorded "decoy" messages. Others bribe monitors to stay away.

Meanwhile, the board has saddled the building with a considerable new expense: wages for the energy monitors. And so it goes. Nothing seems to work. Eventually the monitors are given full police powers and may enter any apartment at any time. How does the board justify this final, draconian step? They cite a twentieth-century authority on the subject. It was Lenin who said, in 1918: "We recognize nothing private."

The scenario is fanciful, of course, because the membership would have elected a new board long before the conflict escalated to such a level; or the members would have sold their apartments and left the building. Nonetheless, it is useful in suggesting that if private property is banished, and exhortation (or "education") is put in its place, both economic efficiency and justice will prove elusive. If coercive measures are introduced, privacy must be swept aside.

## The Morality of Private Property

According to Gresham's Law, bad money drives out good. According to the logic of the commons, bad people drive out good. Consider an example that may appear unrelated to energy consumption: the federal budget. The budget can be thought of as a common pool of money replenished every year with approximately 1.7 trillion dollars from taxpayers. Gathered around the pool are 435 congressmen and 100 senators. What gives them power and influence is that they have exclusive "siphoning rights." They are subject to the constraint that siphoning operations can proceed only if a majority participates simultaneously. When this constraint is satisfied, money can be siphoned out and channeled back to constituents within the congressional districts. The necessary majorities may be achieved by "logrolling": one congressman votes for a project in a colleague's district, in return for a reciprocal favor for his own, and so on.

Federal spending keeps on rising for the same reason that utility consumption keeps on increasing in master-metered buildings. Congress itself is "master metered," because the taxpayers, like the residents of our apartment building, are all "billed" at the same rate, whether or not federal projects are financed in their districts. The point is that the federal tax code is the same in all states. This encourages all legislators to behave like energy hogs—to siphon from the common pool as fast as they can (that is, to vote for most spending bills).

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Suppose that a candidate campaigns on the promise that, unlike his opponents, he will be cautious with the taxpayers' money. He will dare to vote "no" on spending bills when he gets to Washington. The problem is that his restraint, meritorious though it may be, will not encourage a like restraint in others. On the contrary, it will leave more money for them to siphon back to *their* districts. It is unlikely, then, that such a candidate will be elected. But let us assume that he is.

Having arrived in Washington, he figures out something that he hadn't quite visualized on the campaign trail: If he votes "no" on spending bills, he will frequently deprive his constituents of an opportunity to get back from Washington what they put into the common pot (in taxes). So, instead of voting to hold down spending, he joins in the general logrolling, teaming up with other big spenders to form majorities (some of the money being earmarked for his district). Some voters back home, recalling his campaign promise, may think that he "sold out." In reality, it was the institutional arrangement of Congress that encouraged his change of heart, not weakness.

The analysis of the budget as a "commons" helps to explain why voters tend to elect both big-spending legislators and fiscally conservative presidents. Armed with the veto power, and with influence over tax proposals, the president (unlike the separate legislators) is in a position to hold down the size of the overall "pool." It also helps to explain why voters will tend to support limits on congressional terms. They give voters an opportunity, not available in regular congressional elections, to effectively vote against all the other legislators—the ones who are siphoning dollars away to remote and unknown places.

The budgetary equivalent of individual meters would be to change the tax code so that the income-tax rate would be adjusted up or down in each congressional district, depending on how much the Congressman from each district voted to spend in the previous year. Big spenders would then impose high tax burdens on their own constituents. It is a safe prediction that this reform would bring about a rapid decline in federal spending, and all talk of the budget deficit would be a thing of the past. Needless to say, no such reform of the tax system is contemplated. . . .

To return to the condo case, readers will no doubt agree that the installation of individual meters in an apartment building will reduce energy consumption: that is, that it will be economically efficient. But the more important point is that such a change will also introduce the missing ingredient of justice. When Tom leaves his air conditioner running in the summer, knowing full well that it will cost "the building" dollars but him only pennies, the waste may be bad but the injustice is worse. Systematic injustice within a society will introduce a far greater sense of discord than systematic waste.

In his *Summa Theologica*, Saint Thomas Aquinas argued that "the act of justice is to render what is due. . . ." On another page, Aquinas said that "justice, property so-called, is one special virtue, whose object is the perfect due, which can be paid according to an exact equivalence. But the name of justice is extended to all cases in which something due is rendered." By seeing to it that something due is rendered (high utility bills to the squanderers of electricity, low bills to careful users), private property helps to establish justice in the economic realm.

In the condo, then, the effect of privatizing the utilities corresponds exactly to the traditional definition of justice. The great blessing of private property, then, is that people can benefit from their own industry and insulate themselves from the negative effects of others' actions. It is like a set of invisible mirrors that surround individuals, households, or firms, reflecting back on them the consequences of their acts. The industrious will reap the benefits of their industry, the frugal the consequences of their frugality; the improvident and the profligate likewise. They receive their due, which is to say they experience justice as a matter of routine. *Private property institutionalizes justice.* This is its great virtue, perhaps dwarfing all others. We may say with the economists that private property "internalizes the externalities," or with the philosophers that it gives rise to "social justice." □

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THE FREEMAN
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# Just Deserts

by Charles W. Baird

The AFL-CIO has a Web site, www.paywatch.org, dedicated to condemning what it considers to be "runaway CEO pay" in private corporations. It claims that high executive pay damages all other "stakeholders" in corporations, especially workers and stockholders. In other words, the AFL-CIO asserts that excessively paid executives and other stakeholders are locked in a zero-sum struggle.

The Web site had 250,000 hits in 1997. William Patterson, director of the AFL-CIO Office of Investment, boasts that "We put a face on runaway pay in 1997." Betsy Leondar-Wright, an official of United for a Fair Economy, a consortium of religious and activist organizations in league with the AFL-CIO, asserts, "There's nothing like this issue. This one just galvanizes people instantly."[1] Visitors to the site are invited to "fight back" by sending messages to boards of directors, using their clout as shareholders, staging workplace actions, and e-mailing members of Congress.

The site promotes enraged envy. Visitors are told that on average, CEOs make 326 times the pay of ordinary factory workers. The site offers a calculator for envious visitors to compute how long they would have to work to take in what their CEOs took in during the previous year.

The AFL-CIO's agenda is clear: to arrest and reverse the declining market share of unionized labor. Unions represented only 9.8 percent of the private-sector work force in 1997. That figure has been declining since 1953 when it was 36 percent. The site asserts that "Workers have less power in today's economy, which means that executives can take far more for themselves. That wasn't always the case. When unions represented a third of the workforce in the 1950s and 1960s, workers had an effective counterweight to corporate greed." A more powerful AFL-CIO will be able to seize the ill-gotten gains of CEOs and restore them to their rightful owners.

What's really going on with executive compensation? In Chapter 10 of their new text for MBA students, Richard McKenzie and Dwight Lee survey the literature on executive compensation and conclude that, in general, the high compensation packages paid to executives can be explained by some simple economic theory.[2] Far from exploiting workers and stockholders, high executive compensation is a means for all corporate stakeholders to benefit. It is part of a positive-sum game. The authors' explanations fall into two categories, which I call productivity and meta-productivity arguments.

## The Productivity Argument

Top executives are the ones who control most resources in firms. Their decisions affect the performance of all other managers and employees. Excellent executives are scarce, and their talents are economized by putting them at the top where their productivity is

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multiplied through its effect on many others.

General Electric's CEO, Jack Welch, made 1,003 times the pay of the average U.S. factory worker in 1996. His total compensation was $27.6 million in that year. United for a Fair Economy submitted a shareholder resolution that asked the GE board to set "a cap on CEO compensation expressed as a multiple of pay of the lowest-paid worker at GE." GE responded by arguing that Welch's compensation "is appropriate in light of the value that his superior leadership, vision and dedication provided to the share owners during his 17-year tenure as chief executive officer." The total value of GE shares rose by more than $225 billion during that period.[3] Welch earned what he was paid. Moreover, increasing shareholder wealth is good for employees as well as stockholders. A successful corporation provides higher wages and salaries and offers more job security than an unsuccessful corporation.

At Scott Paper, CEO Al Dunlap rescued the firm through radical downsizing and restructuring. As a result he produced $6.5 billion in additional shareholder wealth. His compensation was only $100 million—less that two percent of what he produced. Dunlap asks, "Did I earn that? Damn right I did. I'm a superstar in my field, much like Michael Jordan in basketball and Bruce Springsteen in rock'n'roll." He says, "You cannot overpay a good CEO and you can't underpay a bad one. . . . If his compensation is not tied to the shareholders' returns, then everyone's playing a fools game."[4]

Of course, in the face of imperfect knowledge mistakes can be made, and McKenzie and Lee illustrate such failures. However, when mistakes are discovered, they usually are rapidly corrected. Corporations that allow failed executives to keep their high-paying jobs soon become ideal candidates for hostile takeovers. The market for corporate control never rests. When hostile corporate raiders gain control, they show the door to failed executives.

Sometimes failed executives leave their firms with very golden parachutes. Michael Ovitz walked away from a 14-month tenure with Disney with a $90 million severance package, and it took Gilbert Amelio only 17 months on the job at Apple to get $7 million.[5] More recently, David Coulter was dismissed from Bank of America, after two years on the job and large hedge fund losses, with over $40 million as a consolation prize. Golden parachutes like these are likely to seem excessive to everyone except the recipients, but McKenzie and Lee suggest an explanation.

A newly hired top executive is likely to be much more risk averse with respect to the activities of the firm than its stockholders are. This is because stockholders have diversified portfolios; they own shares in many different firms. If one gets into trouble, perhaps others can make up the losses. In contrast, the executive has all his human capital tied up in the firm. This one firm is the executive's sole employment, and he will be reluctant to undertake risky, but possibly high-yielding, ventures. By consenting to golden parachutes in executive hiring contracts, boards of directors may just be trying to overcome excessive executive risk aversion. On this reading, golden parachutes merely align executive and shareholder attitudes toward risk.

McKenzie and Lee report on several systematic empirical studies of the connection between executive pay and executive productivity. Consider three examples. Sherwin Rosen's research indicates that on average, when a company's rate of return increases by 1 percent, top executive pay increases by 1 to 1.25 percent.[6] Inasmuch as executive pay is a small fraction of company income, those executives earn their keep. Michael Jensen and Kevin Murphy say that on average, executives get only two cents more in cash pay and $3.25 in added wealth for every $1,000 they add to stock values. Murphy concludes that "top executives are worth every nickel they get."[7] James Brickley, Sanjai Bhagat, and Ronald Lease report that on average, stock prices increase by 2.4 percent within two months of the adoption of executive incentive pay over what they would otherwise have been.[8]

The most common form of incentive pay for top executives is stock options, which are rights to purchase shares at a fixed, low price. If the executive is successful, the market price

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of shares will rise, and he will reap large capital gains. This aligns the interests of the executives and the stockholders. On average, stock options make up two-thirds of top executive compensation. That means that two-thirds is at risk. Therefore, part of the high yields received through stock options may be considered just a risk premium.

## Meta-Productivity Arguments

Yet many top executives get compensation that cannot be explained by the productivity argument. They get paid more than they are worth in the narrow productivity sense. McKenzie and Lee offer three arguments to explain such "overpayments."

*Discovery.* Knowledge of who has the ability to become a successful top manager is given to no one. Within a firm top executives have to discover who among the ranks of lower-level managers is deserving of significant promotion. When such a person is identified and promoted, his discovery is announced to the general business community. If the promoted manager were paid only what could be justified by his direct productivity, executive raiders from other firms could easily bid for his services. In doing so, these outside bidders would be avoiding their own costs of search for executive talent. Therefore, a firm that promotes an executive is well advised to pay more than his productivity can justify to be assured of keeping the executive and conserving on future search costs for executive talent.

An interesting implication of the discovery argument is that some people who are not promoted may be just as good as those who are. They are simply undiscovered. To be discovered, it may pay for lower-level managers to acquire self-promotion and schmoozing abilities as well as basic skills for the job. It is possible, McKenzie and Lee write, to acquire "too much in the way of basic skills and not enough of, say, political savvy."[9]

*Self-Monitoring.* It is very difficult, and often impossible, to monitor the performance of top executives accurately. A good executive doesn't follow any prescribed routine that a monitor could observe. A good executive is alert to possibilities of turning all sorts of daily encounters, on and off the job, into profit opportunities. One may say a really successful executive is one who knows how to make it up as he goes along. The only effective monitoring of an executive is self-monitoring. An executive can be induced to self-monitor by a compensation package that substantially exceeds his opportunity cost (worth in the market). An executive who knows that shirking, once detected, means losing the difference between current compensation and what other boards of directors are willing to pay is likely to avoid shirking. This implies that the amount of the overpayment will be positively related to the difficulty of detecting shirking. The more subtle the executive's operations, the higher the necessary overpayment.

*Tournaments.* One way for top executives to motivate lower-level managers to work as hard and smart as they can is to make clear that rungs on the managerial ladder get increasingly narrow as it is climbed. Firms following this strategy purposefully hire many more low-level managers than they can possibly promote, and they make sure that new hires understand that this is true. Promotions are awarded to the few who can successfully compete for them. At each stage the tournament prize is a promotion and a substantial increase in pay that cannot be justified on narrow productivity grounds. Why does the pay increase have to be so large? Because the contestants will naturally discount the increase by the probability of achieving it. The higher up one is on the managerial ladder, the lower the probability of climbing still farther. Therefore, the gaps in pay must grow as one climbs from one rung to the next.

The institution of a tournament has at least two effects among the contestants. First, those who think they have little chance of winning will self-select out of the contest. Job seekers will not accept jobs with the firm to begin with, and those who are already with the firm will leave and seek more accommodating employment elsewhere. Those with substan-

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tial self-confidence will remain. This increases average productivity. Second, competition among the contestants who are willing to play the game will make all of them exert more effort and avoid shirking. All contestants will be more productive than they would have been without the tournament. The "overpayments" that accompany promotion are paid from the added output of the enterprise as a whole rather than the individual productivity of the prize winners.

Gaps in compensation between top executives and average workers are increasing. The tournament model explains this. Deregulation and globalization of competition have flattened firms' managerial hierarchies. Middle-level management positions are being eliminated and replaced with floor-level team decision-making monitored increasingly by pay-for-performance schemes. These changes in organizational architecture enable firms to respond more quickly to rapidly changing market conditions. The changes also mean the managerial ladder is becoming narrower faster. Thus the probability of lower-level managers being promoted to top executive positions has substantially decreased. To keep a tournament viable under these circumstances, the gaps between top-level and average compensation must grow.

It should not be surprising that the AFL-CIO violates the Tenth Commandment's proscription against envy. Unions have never been reluctant to exploit misunderstanding of economics for their own gain. The executive pay issue is just the most recent example. The only remedy is for people who do understand economics to expose the spurious reasoning of the enemies of freedom. We should be grateful to McKenzie and Lee for having done so in this case. □

1. Robert L. Rose, "Labor Has Discovered the Perfect Issue For Galvanizing Workers: CEO Pay," *Wall Street Journal Interactive Edition*, April 9, 1998.
2. Richard B. McKenzie and Dwight R. Lee, *Managing Through Incentives* (New York: Oxford University Press, 1998).
3. Rose.
4. McKenzie and Lee, p. 160.
5. Ibid., p. 171.
6. Ibid., p. 161.
7. Ibid., pp. 162–63.
8. Ibid., p. 164.
9. Ibid., p. 165.

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# Night of the "Living Wage"

For years, FEE has stressed the supremacy of sound economics over the political process. If people understand how markets work, and the vital link between free markets and personal liberty, they will support the right policies and the men and women in public office who implement those policies. Those who stress politics first, and concentrate their resources and efforts there, are putting the proverbial cart before the horse. Now from Detroit comes painful evidence of how true this principle is.

On November 3, Detroit voters overwhelmingly approved a so-called "living wage" ordinance that requires employers with at least $50,000 worth of city contracts or financial assistance to offer a minimum hourly wage of $7.70 if health benefits are included or $9.63 if they are not. Furthermore, the law requires that employers hire only city residents. Violators are subject to a $50 per day penalty and may have their city contract or grant revoked as well. The city's already bloated bureaucracy will get larger now because contracts will have to be monitored for compliance, which also means that businesses will be forced to reveal confidential payroll information.

This is magic-wand economics at its worst: Want higher wages? Just pass a law making it illegal to pay anything less than some arbitrary amount. Presto! Supply and demand, profit and loss, incentives and disincentives all mean nothing if you can get what you want through the force of law.

Of course, there's nothing in the ordinance that will make workers more productive, only less affordable. A city that has already driven out a million people and countless businesses with a tax burden more than six times the average for Michigan municipalities will now become even less competitive and economically attractive. David Littmann, senior economist at Detroit's Comerica Bank, estimates that the ordinance will wipe out about 7 percent of the city's jobs by the year 2000. Incredibly, Mayor Dennis Archer, who publicly supports the living-wage concept, headed to Washington within days of the vote, seeking federal assistance (that is, other people's money from all over America) to help keep businesses from leaving Detroit.

And it isn't just businesses that will be affected. Nonprofit charities will be too. For example, two Salvation Army sites in Detroit receive $300,000 from the city. Most conservative estimates put the new law's cost to the Army at $1.5 million. The Army will have to raise an additional $1.5 million, lay off workers, or become independent of the city.

Every argument against the minimum wage—long familiar to readers of *The Freeman*—applies in spades to living-wage proposals like Detroit's. The law can't make a person worth $5.15 an hour (the current federal minimum) by making it illegal to pay him any less. By mandating an even higher minimum, the living wage prices even more peo-

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ple out of work. The people who push these cockamamie ideas never seem to ask why any employer would hire someone at $7.70 if that person's services are only valued in the marketplace at, say, $5.

Moreover, by imposing more unnecessarily costly employment arrangements, the new law will require more city revenue or reduced city services. The long and short of it is this: though some workers may keep their jobs and even see their wages hiked, others will pay the price in the form of fewer jobs or higher taxes. Unemployment resulting from the law will boost the public welfare rolls in a city where the poverty rate—at 30 percent—is already the highest of American cities.

Detroit, sadly, is not the first municipality to engage in such foolishness. In 1994, Baltimore became the home of the country's first living-wage law. Portland (Oregon), Milwaukee, Minneapolis, St. Paul, Jersey City, Boston, and Los Angeles have all adopted similar ordinances. Last fall, the city council of San Jose, California, began debate on a living-wage ordinance that would set minimum hourly pay at an astounding $12.50 plus benefits for employees performing work for the city. On top of that, the San Jose proposal stipulates that any contractor who takes over a city job previously performed by another entity would be forced to hire the same people who had been doing that work before.

Who is behind these silly laws? In Detroit, the ballot language was drafted and the campaign funded by none other than organized labor. Why? Because a city floor under wages will stifle the unions' low-cost competition and make it more difficult for the city to contract out for services. This is not organized labor playing the role of Florence Nightingale. It is the cannibalization of fellow workers by greedy, self-interested union bosses.

Nationally, the living wage effort is being led by a group known as the Association of Community Organizations for Reform Now (ACORN). Like the unions, ACORN is no paragon of either altruism or intellectual consistency. Even as it was arguing for the federal minimum of $5.15 and lobbying for sky-high living wages in a number of places across the country, ACORN filed a lawsuit in California in an attempt to exempt itself from paying its own employees the state's then-current $4.25 per hour minimum wage. In its legal brief, the organization declared that "the more that ACORN must pay each individual outreach worker . . . the fewer outreach workers it will be able to hire." Hypocrisy has rarely been on more arrogant display.

Meanwhile, some people and certain business organizations in Detroit that have long viewed the promotion of free-market economics as "too controversial" for their tastes are now reaping the bitter harvest of their "moderation." In challenging the new law in the courts, they may spend far more than they ever spent on behalf of economic education. Whether they learn anything from it all remains an open question.

Too often, in Detroit and elsewhere, the schools don't teach sound economics; or worse, they teach the toxic stuff. Businessmen devote too much of their resources to politics and too little to the right ideas that can really make a lasting difference for the better. That's why living-wage nonsense succeeds in becoming law. We shouldn't be surprised at the results, and we should be ashamed if by our action or inaction we're part of the problem. □

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THE FREEMAN
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# Crimes of the Mind

by Melissa Suarez

The killing some months ago of Matthew Shepard has brought to the forefront of debate the idea that a federal law is needed to protect people against "hate crimes." Proponents want the law to punish individuals who target others because of race, sex, religion, disability, or sexual orientation.

The murder of Matthew Shepard of course is tragic. That it was likely committed with hatred for his sexual orientation is indeed also tragic. A federal law against hate crimes, however, could never be constitutional nor could it protect likely victims of such crimes.

The U.S. Supreme Court has already unanimously struck down a hate-crime law. *R.A.V. v. City of St. Paul* involved a city ordinance in St. Paul, Minnesota, that prohibited the display of a symbol that arouses "anger, alarm or resentment in others on the basis of race, color, creed, religion or gender."

Several white youths were charged with violating that ordinance when they burned a cross on the property of a black family. The flaw with the ordinance was that it was neither content-neutral (concerned not with the speech's content, but where, when, or how it takes place) nor viewpoint neutral. Writing for the Court, Justice Antonin Scalia said the ordinance was invalid because "it prohibits otherwise permitted speech solely on the basis of the subjects the speech addresses."

Content and viewpoint neutrality will derail future hate-crime laws as well. The best alternative would be to heed Scalia's words, when he wrote that governments have no authority "to license one side of a debate to fight freestyle, while requiring the other to follow the Marquis of Queensbury Rules."

## Campus Speech Codes

Consider how similar legislation, specifically "hate speech" codes at colleges and universities, have fared. Campus speech codes that punish students for speech, slurs, or epithets that relate to a person's race, gender, religion, or sexual orientation are prime candidates for lawsuits because they, too, lack content and viewpoint neutrality.

The most famous incident involving hate speech began in January 1993 at the University of Pennsylvania. Five black, female students claimed they were victims of racism after a fellow student, Eden Jacobowitz, who was interrupted in his studying by their boisterous behavior outside his window, yelled at them, "Shut up, you water buffalo." Jacobowitz was charged with violating Penn's speech code, which prohibited racial harassment.

The administrative judicial officer in charge of his case, in a telling question, asked him if he was "having racist thoughts" when he used the term "water buffalo," because, the administrator said, a water buffalo is a dark, African

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animal. Jacobowitz vehemently denied his remarks were racist, saying that the students' noise and not their race prompted his remark. Several scholars rushed to Jacobowitz's defense, including black professors at Penn who said there were no racial connotations behind the term "water buffalo." Others pointed out that the water buffalo is found not in Africa but in Asia.

Nevertheless, because of the code, Jacobowitz's fate depended on the black students' interpretation of his remark. They decided it was racist, so the university charged Jacobowitz with racial harassment. The university eventually dropped the charges.

Another problem that hate-speech codes have, and hate-crime laws inevitably would have, is related to their lack of viewpoint neutrality. These codes are not all-inclusive. They are usually so vaguely worded that the ban is generally on hate speech only by speakers of a certain gender and certain races, sexual orientations, religions, or handicaps.

Sheldon Hackney, who was president of the University of Pennsylvania during the "water buffalo" incident, blatantly admitted the codes' selectivity. When someone asked Hackney if "racial harassment" would include "someone [who] called a black with white friends an 'Uncle Tom' or an 'Oreo,' or if someone called a white person a '[expletive] fascist white male pig?'" Hackney said no.

## Punishing Thoughts, Not Acts

A federal hate-crime law would also threaten selective enforcement. Such a law could easily be used to protect only certain groups and punish only certain crimes as hate crimes, thereby making some forms of "hate" more punishable than others.

The alternative would be to punish all hate crimes equally, which would be impossible. It would also be superfluous. For example, in Shepard's case, there are already laws against murder, and the penalties are greater than those of any proposed hate-crime legislation.

Nevertheless, many people argue that a federal law against hate crime could possibly stimulate education about racism, sexism, homophobia, and the like. It would also, they say, probably make minorities feel more protected. It's known in some circles as "thought control."

Consider the success of hate-speech codes in this area. At many institutions, students who violate the speech code are required to take classes on the dangers of prejudice and stereotypes. At UCLA, for example, violators of the university's anti-harassment policy usually must either perform several hours of community service or "become educated" about harassment. One student accused of sexual harassment had to establish a program to educate his fraternity about sexual harassment and write a paper for the dean of students on heterosexism and the origins of programs that combat sexual harassment. Similar punishments are handed down at other universities.

One wonders what kinds of "community service" and "education" violators of a federal hate-crime law would be subjected to. After the federal government charged an individual with having the wrong thoughts (which is already a blatantly unconstitutional action), would it then force him to change his mind? The last government to do that was Ingsoc, in George Orwell's *Nineteen Eighty-Four*.

Supporters of hate-crime laws also argue that federal legislation might heighten awareness about prejudices and stereotypes. More important, they say, stiffer penalties for those who commit such crimes would deter them to begin with. How could they serve as a deterrent when the act itself is already a crime?

A federal hate-crime law would also raise questions of double jeopardy. If, for instance, a black person's accused assailant is acquitted at the state level, he could be retried for the same crime in federal court under the hate-crime law.

We can never know for certain the motive behind a person's speech or action. For that and other reasons, laws designed to punish the thought behind the crime are dangerous and inappropriate in a free society. □

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# Mises on Mexico

by Eduardo Turrent

Today should be a day of celebration for students, book lovers, and all who are interested in reflecting on the economic development of Mexico. *Mexico's Economic Problems* by Ludwig von Mises, which Bettina Greaves found in 1997 among Mises's papers, is truly a treasure.[1] Although there are obvious differences, it calls to mind musicologist Alberto Gentili's rediscovery in the 1920s of the complete works of Antonio Vivaldi, more than 200 years after the composer's death. We economic historians are more fortunate than musicians and music lovers were, since Mises's text has reappeared only 25 years after his death.

The monograph by Mises on the Mexican economy is outstanding in many respects. One particularly important aspect is that it is relevant to more than just the economic situation he found when he visited in 1942. Mises was concerned with the long-run historical context; or as one says nowadays, he focused on fundamental structural change. He was interested in uncovering the fallacies on which the principal positions and policies of Mexico's former socialist regime, as well as all socialist regimes, were based.

One of the principal points in Mises's essay was his vote of confidence for Mexico because of the capabilities of its people and the progress of the country. As he put it: "It is beyond doubt that the Mexicans are endowed with the spirit of workmanship. The achievements of the autochthonous [indigenous] craftsmen and artisans meet with the admiration of all experts. The workers in the already existing industrial plants and in the mines are not less efficient than those of other countries." And the same may be said with respect to their entrepreneurial and other skills.

Thus the problem of Mexico's development was not capital scarcity, geography (which Mises judged favorably), climate, or geology, even though the soil "in the greater part of the country is dry and barren." Development depends on the application of "an appropriate economic policy"; that is, a "wise" economic policy aimed at the "establishment of a durable system resulting in a continuous improvement of the nation's well-being."

Unfortunately, this was not the case in Mexico when Mises wrote this paper. Nor has it been the case since, especially not from 1970 to 1982, even if one considers the several forms such a "wise" policy may take.

## Attack on Easy Money

Only five or six years after the publication of Keynes's *General Theory,* Mises took a well-aimed shot at the economic policies that

*Eduardo Turrent is the historian of the Bank of Mexico. This is excerpted from a paper delivered at a conference of the Ludwig von Mises Cultural Institute of Mexico City, September 23–24, 1998, celebrating publication in Spanish of Ludwig von Mises's* Mexico's Economic Problems: Yesterday and Today, *which was written in 1943 but unpublished until last year. Translated by Bettina Bien Greaves.*



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stemmed from the noted English author's ideas. According to Mises, the "easy money" policies of the interwar years, policies that tended to generate inflation, had been based on the doctrines of Lord Keynes, doctrines that Mises called "fallacious." To Mises, the Keynesian dictum that "in the long run we are all dead" was no more than a new version of the cruel-hearted motto attributed to Madame de Pompadour, "After us, the deluge." Thus, every strategy that "is indifferent about the tomorrow strives after ephemeral success and carelessly sacrifices the future." Such strategies must not be considered "progressive, but parasitic." Growth may be sustained only by having fundamental policies favorable to the stability of money and exchange.

Mises said in this study, not without cause, that the monetary history of Mexico, like that of many other countries, has been "a record of failures and disasters." He hit the bull's-eye when he said that "Monetary troubles are never the inextricable outcome of conditions beyond the control of a country's government. They are always the result of a deliberate policy," which, only too often, has been "the result of erroneous monetary doctrines." Thus, with a nod to the then-current financial authorities in Mexico, Mises pointed to the need to return to a firm path toward stability.

But stability is not a goal in and of itself. "Monetary stability" must be recognized as a means, "an indispensable requirement for the formation of capital." Moreover, the consequences of applying an "easy money" inflationary policy are, and have been, economic depressions with millions unemployed and social unrest. "Easy money" policies "result for a short time in the creation of an artificial boom, but must later end in a slump and in depression."

Few of the wise observations, prescriptions, clairvoyant remarks, and even prophetic visions in Mises's text appear obsolete, not even his proposals concerning exchange. Nevertheless, one must remember that this manuscript was written years before Bretton Woods and more than a decade before the celebrated article by Milton Friedman, "Fixed vs. Flexible Exchange Rates" (1953). It should not be surprising that Mises showed

*Ludwig von Mises*

himself in 1942 to be an advocate of the gold standard. However, one should look at the matter from the perspective of history. Basically, what Mises wanted was not something radically different from what Domingo Cavallo introduced in Argentina, fixed exchange with a monetary policy subject to discipline.[2]

At a time when public deficits have come to be considered virtuous, Mises insisted on the advantages of fiscal health. He explained clearly that excessive public spending contributes neither to disposable income for the masses nor to the supply of social capital. If the public budget is in disequilibrium, this must be financed either by issuing central bank credit or by using internal debt. If central bank credit is used to finance the public debt, it is doubly pernicious because, in addition to leading to inflation with all its harmful consequences, it affects the balance of payments and hinders the maintenance of exchange stability. If internal debt is used to finance the public debt, wealth is simply withdrawn from the private sector and transferred to the public sector. Public spending proposals assume, also, that the government will spend resources better than individuals will. But is this by any means certain? Withdrawing purchasing power from the private sector not only reduces the total resources entrepre-

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neurs will have available to invest, but it may also reduce the income and consumption of the needy.

It is possible, even likely, that in his Mexican travels under the guidance of Montes de Oca, Mises became acquainted with the Mexican historian Daniel Cosio Villegas. Mises's opinions concerning the apparent and abundant "natural wealth of Mexico and the chances of its future prosperity" were contrary to the views then commonly held. But they were remarkably similar, particularly in emphasis and approach, to those expressed by Cosio Villegas in his essay "The Legendary Wealth of Mexico." Mises's sharp observations were, and still are, particularly applicable to the agricultural capabilities of Mexico. To Mises the natural supply and quality of the land were not insuperable obstacles. Rather, he looked on agricultural policy, which was rooted in the heart of the revolutionary ideology, as the obstacle to the country's progress.

Mises cited figures to illustrate what he called the harmful effects "of the agrarian reform of the revolution." The crops of corn and wheat had been much less in 1937 than in 1907 and those of beans less than in 1897. Mises saw clearly, as did Manuel Gómez Morín and a few other illustrious intellects, that in Mexico, as in any other country, the agricultural sector could not make progress without a clear definition and absolute respect for the rights of property. The plain fact was that those rights were not well defined in the arrangement made for common land. Therefore, land was not only not cultivated with the devotion required, but investments necessary for the development of the land were not made either.

The right to property is the necessary condition for all modern productive activity. Therefore, Mises argued strenuously in 1942 against the desire of many to look to the Soviet system of agricultural collectives as the example for Mexico to follow. Granting that, however, Mises did not object to, and he even looked with favor on, other forms of collective activity even with the active participation of the state. For instance, he mentioned cooperatives that could be formed to acquire farm equipment, seed, and fertilizers, and to cover other expenses. Such cooperatives could also arrange for leasing machinery, selling farm produce, and obtaining credits for members. The government could also help with institutions to promote technological education and agricultural research. Nevertheless, every individual farmer should be "the master on his own farm."[3]

## The Demographic Problem

Surely Mises was one of the first visionaries to recognize the demographic problem from which Mexico has long suffered. Mexico, he noted, is "a comparatively overpopulated country," with the surplus population living in rural areas. The potential productivity of the country was insufficient to assure a decent standard of living for these excess people. Therefore, the only viable solution was for industries to be developed to absorb that excess population. But truly productive industries could develop only in response to definite commercial opportunities.

In 1942, Mises called for something that was then strictly taboo, something that could not be undertaken in Mexico until more than four decades later: an "open door" trade policy. If the dismantling of our ancient protectionist structure in recent times provoked no few laments and rending of garments, imagine the reaction to the Austrian economist's proposal in the 1940s, in the midst of the great World War. Contrary to archaic mercantilist doctrines, Mises looked on imports as something desirable; he considered the opening of trade as the indispensable means for obtaining the best possible allocation of resources. "The advantage derived from foreign trade lies entirely in importing, not in exporting," he said. According to Mises, only by competitive industry emerging in an open environment can manufactured products be produced at prices that permit living standards in the country to rise while at the same time generating exports to pay for the nation's indispensable imports. The problem, he lamented, is that many Mexican patriots were "entangled in the neo-mercantilist fallacies" then in vogue—and I would say still in vogue among many groups.

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The whole process of industrialization based on protectionism is damaging in three ways. First, protection inhibits the agricultural sector from exporting. Second, it raises the prices of manufactured consumers goods, which could otherwise be acquired by the rural inhabitants. And third, because of its high costs, industrialization based on protectionism prevents the manufactured products from penetrating international markets. It is true that, given such industrialization, many people would find employment in the protected industries. But what they would gain as employees others in other sectors of the economy would lose through the high cost of the manufactured articles. In this way any possibility of raising "the standard of living of the average Mexican" would be lost. Therefore, Mises concluded, industrialization by means of protection would lead the nation down a "blind alley" since it would perpetuate the low living standards of the people.

Although Mises argued for opening up trade gradually, he predicted that there was no need to fear that, by removing tariff barriers, "any plant will be forced to discontinue production. Some plants, it is true, will have to rearrange their lines of production in order to obtain a higher degree of specialization." But, to the great surprise of many, the visiting Austrian recommended opening up trade unilaterally—removing commercial barriers even though other countries maintained protective policies without offering commercial reciprocity.

Mises's expectations about opening the country up to trade were absolutely correct, as they were in other instances. Although the Mexican opening was not gradual and the policy adopted was unilateral in the beginning, practically no failures that could be attributed to that fact were reported.

Mises explained how the opening up of trade, with all its benefits, cannot yield its full benefits without a coherent and a compatible wage policy. Today those who think real wages can be determined by decree or by employer-employee negotiations still organize in battalions. But those who are serious know the painful consequences of such a wage policy; it directly diminishes the competitiveness of enterprises and employment, and indirectly affects inflation and economic growth. As Mises expressed it:

> There is but one means to raise Mexican wage rates: industrial expansion. Every new plant improves the standard of living of the Mexican masses by creating an additional demand for labor. But industry cannot allow higher wages than such as safeguard the conduct of business. If trade unions are anxious to enforce higher wages, they prevent the establishment of new plants and the expansion of existing plants. They succeed, it is true, in raising wage rates for a comparatively small group of workers; but they force, on the other hand, hundreds of thousands to remain in agricultural occupations, in which their income is extremely low, i.e., much lower than it would be if they could find industrial jobs.

Mises was absolutely clairvoyant in suggesting in 1942 that private initiative should participate in the production of petroleum, the management of the railroads, and the generation of electricity. He was also right in insisting that unless investment and production have confidence, they cannot thrive and thus cannot contribute to economic progress.

## Railroads, Electricity, and Petroleum

More than half a century after Mises's visit, his recommendation with respect to the railroads is becoming a reality. In the case of investment in the field of electricity, there are now indications that private capital will be permitted greater participation in the future. As for the production of petroleum, we are still far from a decision; some isolated voices suggest only occasionally, rather timidly, that the matter be reconsidered.

Further, Mises was several decades ahead in predicting what would happen in Mexico between 1970 and 1976 with respect to cooperativism. In that six-year period the management of cooperatives in some sectors, like that

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of fishing, was entirely given up. The results had been very disappointing; they fulfilled to the letter what Mises had written years before. "No serious economist believes that a cooperative society could successfully compete with private enterprises. The experiments have resulted in complete failure." This, he said, applied especially in the field of industrial production.

One of the themes emphasized in Mises's essay is the importance of maintaining the confidence of investors in order to improve the country's material welfare. In *Mexico's Economic Problems* there are more than ten references to this. On this point Mises was absolutely positive: "What Mexico needs most is capital, either foreign or domestic. The repudiation of the national debt and the expropriation of foreign investments deter the foreign capitalist. The methods of taxation prevent the accumulation of domestic capital."

The investor, domestic or foreign, fears every attack on property rights, lack of public safety, and arbitrariness. Strictly speaking, when we consider the situation, confiscatory taxation is aggression against the right of property. According to Mises, very high taxes "paralyze the spirit of entrepreneurship." Therefore, he recommended that Mexico distance itself from a "suicidal" tax policy of this kind. Taxes should never discourage saving or the accumulation of capital. In this same vein, personal and entrepreneurial income that is invested should be taxed at a lower rate.

Mises's essay is enlightening and clear; it refutes fallacies, destroys myths, is analytical, and advisory. When it was first written and made available in Mexico, it had practically no effect; in fact it was forgotten. Why? I venture a few theories.

First, his views were in opposition in many regards to the most widely accepted ideas of the time and the years to follow. Moreover, there was resistance from the powerful groups that were surely disturbed, or would have been disturbed, by this text. International experience reveals that one of the great obstacles to undertaking reforms is special-interest groups. And Mises's paper touched directly on many of them, especially syndicalism, the agrarian reform bureaucracy, the administrators of public enterprises that would be dismantled, the industrial beneficiaries of protectionist measures, the clientele of subsidized organizations, and even the teachers who were preaching in the schools and universities "the religion of étatism." In this connection, Chapter XI of Mises's essay, "Education," is recommended.

However, as Keynes said, the ideas of economists and social philosophers are more powerful than generally believed. There is a tendency to exaggerate the power of special interests as compared with the gradual penetration of ideas. And something that Keynes did not say, but which I firmly believe, is that in the long run, correct ideas will succeed in asserting themselves over the fallacies and the economic deceits. □

1. Translated into Spanish as *Problemas Económicos de México, Ayer y Hoy* by Daniel Sotelo Kucharik and Ana María de Sotelo (Mexico: Instituto Cultural Ludwig von Mises, 1998). Publication of the original English-language version is scheduled by Liberty Fund of Indianapolis in Volume 4 of *Mises's Lost Papers*.

2. Domingo Cavallo, formerly associated with Argentina's central bank, became foreign minister and then minister of economic affairs under President Carlos Saúl Menem. He was instrumental in stopping the inflation, establishing a currency board and stabilizing the exchange rate of the Argentine peso at one U.S. dollar.

3. *Editor's Note*: Mises wrote in his 1943 manuscript that "The economic backwardness of a part of Mexico's agricultural population justifies intervention on the part of the government. It is all right for the government to advise the peons how to establish and to run co-operatives. Even small subsidies for newly formed co-operatives may be advocated. But it would be a mistake to subsidize them permanently or to grant them tax privileges. It does no good to mask the failure of any institution by such measures. Mexico is not rich enough to indulge in the luxury of waste."

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Government

# America's Forgotten War

The war that did the most to transform the world for the worse was formally settled 80 years ago. Not World War II, which employed greater destructiveness, exhibited greater cruelty, and slaughtered greater numbers of people. But World War I, which birthed World War II, along with the greatest of the totalitarian delusions—communism, fascism, and Nazism. Yet the Great War, as it was originally called, is largely forgotten in America.

Today the United States celebrates Veterans Day on November 11, which replaced the original Armistice Day. But when Americans think of veterans they think of Vietnam, Korea, and World War II. Not so in Europe. There World War I continues to loom large.

As it should. The Triple Entente, with which America was allied, had won when the guns fell silent on November 11, 1918. But as the Versailles peace conference, which opened in January 1919, proceeded throughout the spring, the Western powers managed to lose the peace. Tens of millions in the next generation would pay for their mistakes.

And the Europeans continue to fight leftover issues of the war. For instance, last November French Prime Minister Lionel Jospin suggested rehabilitating army mutineers who had been executed during a massive soldiers' revolt in 1917. President Jacques Chirac sharply rejected Jospin's idea, however, citing the negative reaction from surviving veterans. Yet at the same time the British government allowed relatives of soldiers executed for cowardice and desertion during World War I to hold a ceremony at the Cenotaph, Whitehall's monument to the war dead.

To the extent that Americans know anything about the war, they probably think of supposed idealist Woodrow Wilson leading the fight to make the world "safe for democracy." This was pure cant. Instead, Wilson was dedicated to reforming the entire world and would have a chance to do so only if he headed a belligerent power. His high-flown rhetoric disguised the fact that he had allied America with one militaristic bloc against the other.

While Germany helped bring on the war by isolating itself and adopting a hair-trigger mobilization plan, it was not bent on war. German diplomacy after Chancellor Otto von Bismarck was maladroit and stupid, not malicious.

France, in contrast, was aggressively revisionist. It wanted to recover the provinces of Alsace and Lorraine, lost in 1871 in the aftermath of the Franco-Prussian War (which had been started by France). This required not just war between France and Germany, but a European-wide conflict, since France alone could not defeat Germany.

Austria-Hungary, Germany's ally, was also a status quo power, desperately seeking to avoid internal collapse. In contrast, Italy, which eventually joined the Entente, desired

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Austro-Hungarian territory; Russia hoped to gain influence in the Balkans at the expense of Vienna.

Most important, the blood-stained Serbian regime, built on the brutal murder of the king and queen of the previous dynasty in 1903, wanted to break apart Austria-Hungary in order to build a greater Serbia. In fact, it was the Serbian-supported assassination of Austria-Hungary's heir apparent that lit the fuse of the war. The contending alliance systems acted as transmission belts of war for all of the major European powers.

After the deaths of some ten million people, all the contending nations' goals looked downright frivolous. Washington's formal justification for war was its desire to protect the right of Americans to travel on armed British merchantmen carrying munitions through a war zone.

The celebrated *Lusitania*, sunk by a German U-boat in 1915, carried just such a mixed cargo of babies and bullets. Wilson's eloquence notwithstanding, the Germans were perfectly justified in sinking it and other such vessels. In fact, there is a continuing controversy over whether British officials, particularly then-First Lord of the Admiralty Winston Churchill, hoped the *Lusitania* would end up on the ocean floor, thereby inflaming American opinion against Berlin.

The war offers many ugly precedents. There was, for instance, the brilliant British propaganda, which convinced the world that the "Huns" were ravaging Europe. Alas, it was all false, but it helped drive America into the war. Joseph Goebbels modeled the Nazi effort after that of the British.

There was also the war against noncombatants. London imposed a "hunger blockade," denying foodstuffs to all European civilians, even though it was against international law. Britain maintained the blockade even after Germany had surrendered. Hundreds of thousands died of starvation.

Finally, soldiers were treated as cannon fodder to be slaughtered. The Western front became a static "sausage machine" once trenches stabilized positions in the fall of 1914. From then through the spring of 1918 no attack moved the lines more than ten miles.

The French mutineers about whom Chirac and Jospin quarreled represented soldiers refusing to lose their lives in useless offensives pushed by fantastically overoptimistic generals who commanded far from the front. Who could blame the *poilus* for resisting?

Especially since the politicians knew what was going on. British Prime Minister David Lloyd George admitted that people could not be told the truth about the war or they would end it the next day. He finally limited troop replacements to the front because of what he termed the generals' "reckless wastage of the manpower so lavishly placed at their disposal."

No one was immune from the effects of this reckless wastage. The carnage sparked revolution in Russia, breakup in Austria-Hungary, dissatisfaction with democratic politics in Italy, and, most important, collapse in Germany.

Unfortunately, after all this mindless bloodletting, the Allies came up with a peace that French Marshal Ferdinand Foch presciently called "an armistice for 20 years." The Allies blamed Germany for the war, dismembered Austria-Hungary and the Ottoman Empire, plundered the defeated states, awarded Third World peoples to the victors like prizes in a sporting competition, and mixed different ethnic groups in a host of unstable new nations.

A decade later Britain was embarrassed by its handiwork and refused to defend it; France lost the will to act alone. They would neither ruthlessly enforce Versailles to contain Germany nor voluntarily revise the treaty to conciliate Germany. Then came Adolf Hitler, and the Allies yielded on every point. World War II was not long in coming—followed inexorably by the Cold War.

Even today we are not free of the lingering effects of World War I. The continuing Balkan civil wars are a bloody bit of unfinished business from Versailles in 1919.

The world was full of hope 80 years ago, as Allied leaders sought to create the world anew. But they failed: not only did ten million people die in vain, but some 40 million more would perish a generation later. It is the kind of history that we cannot afford to repeat. □

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# Frontiers: Last, Lost, and Found

by Eric Nolte

Technological innovation is the most powerful force for improving our safety and health, but such creativity withers under government control. It flourishes in the rich soil of freedom.

Government intervention subsidizes businesses that are mediocre, obsolescent, and inept. Such firms survive not because they have won consumer dollars through the logic of superior products and voluntary trade with consumers, but because they have succeeded in lobbying for legislative advantages that hobble their betters in the marketplace and stifle the creativity behind innovation. Aviation presents many examples of this.

At one time a small factory-built light airplane could be purchased for the price of a nice automobile. No more. Those who want a little Cessna now need to raise enough money for a home mortgage, not a car loan.

While aviation electronics have seen big advances, that is largely a result of the boom in computers and consumer electronics that has proceeded mostly without government interference. But the structures, materials, and power plants used in the construction of light airplanes have not improved much for half a century. Between the huge costs of government regulation and the way tort law has been interpreted for decades, manufacturers of small airplanes have either gone bankrupt or focused on producing more expensive aircraft for business.

In 1996, Cessna announced the production of its homely model 172 for the first time in nearly two decades, thanks to the recent changes that Congress authorized to protect manufacturers from completely open-ended liability claims. This is virtually the same airplane that Cessna had produced since the late 1940s till 1978. The price? Around $200,000, three times its cost in its last year of production.

## The Will to Create

The human yearning to create and improve things is like a flower that wriggles out to sun and air from under rocks. While regulation and the tort system have destroyed much innovation in small, commercially produced airplanes, a loophole in federal legislation allows average people to build airplanes at home. They buy plans and parts for simple airplanes, and network with others under the auspices of the Experimental Aircraft Association. While the name suggests an organization devoted to cutting-edge matters, their primary function is to help ordinary citizens get into the air with simple machines.

One part of the EAA's membership is devoted to advancing aviation. It produces kits that make good use of new composite materials, new power plants, and structures to produce machines that in their performance and convenience put to shame anything

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offered by today's makers of little planes. For example, the Beechcraft Bonanza, which first rolled off the Wichita production line in 1945, is still among the hottest factory-produced private airplanes in general aviation. In efficiency, speed, and comfort, it is a dinosaur compared to what home-builders can offer today.

Much attention has focused on the benefits of airline deregulation to the flying public. Airline traffic is twice what it was in 1978, encouraged by fares that are so much lower that airline travel has become the primary mode of traveling long distances.

Little known is that airlines remain among the most highly regulated industries in the country. The highly touted deregulation of 1978 merely allowed airlines the power to set rates and choose which cities to serve.

One result of regulation is that airliners today neither look nor perform much better than those introduced 40 years ago. What would airliners look like absent government regulation? And how might this contribute to advancing aviation safety?

Compare the huge leap in safety that occurred when the old piston-engine airliners were replaced by the jets that started coming online around 1960. Suddenly, instead of getting their feathers knocked off as they slogged through nasty weather systems down in the lower reaches of the troposphere, jets had the speed and range to top or circumnavigate much of the bad weather. The improvement in comfort and safety was a quantum leap over those of the old propeller-driven transports.

The technology has existed for decades that would allow a similarly dramatic improvement over the current generation of jets. But trying to use much of this technology is as hopeless as trying to compete with the post office. It's forbidden by law.

Those who are familiar with particular fields, as I am with my profession of aviation, are in a position to have some idea of what might be. Abundant technology is on hand today that would astonish you.

## Air Orient Express

In my professional opinion, if it weren't for regulation, we would already have in operation, at the very least, a true Orient Express: a second generation of big, long-range, supersonic jet transports (SST) that would be quieter, environmentally cleaner, and more fuel efficient than the Concordes and similar products that were on the drawing boards at Boeing, Lockheed, and Douglas in the 1960s. But the government—in thrall to the politically connected lobbyists, Luddites, and human-haters of the time—passed legislation that killed all such efforts before the first American SST appeared even in prototype.

It is also my belief that we would have—or would shortly have—viable, reusable, single-stage-to-orbit rockets, plying the skies in low-earth orbit between Europe, the Americas, and Asia, carrying mail, people, and high-priority freight with greater safety, speed, and value than anything we have today.

The whole history of technology validates this point. And these are not the most impressive innovations that G. Harry Stine outlines in his book *Halfway to Anywhere: Achieving America's Destiny in Space*. Stine presents a sample business plan produced by experienced venture capitalists that marshals scientific and economic savvy. The plan shows how big profits are available to those who get into low-earth orbit, from where, as science fiction author Robert Heinlein put it, one has already expended the energy to be "halfway to anywhere in the solar system." Big floating space stations would serve as hotels for gawkers and well-to-do honeymooners. Factories in space (as Stine pointed out in his 1979 book, *The Third Industrial Revolution*) could exploit the unique characteristics of a zero-gravity environment that would allow the production of certain drugs and the use of some industrial processes that are simply impossible outside that environment. Earth-orbiting industries could serve as hubs for mining precious resources from the asteroid belt. Getting into space would allow human beings to transform the earth into a new garden of Eden, at a pace set by the rewards that market forces offer us for moving off the planet. (Getting into space ultimately promises an answer even to the threat that will otherwise doom human beings when our sun begins to burn out.)

More immediately, getting into space

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promises a renewal of the psychological benefits long said to have ended with the closing of the American frontier a century ago. It might restore the idea of progress, the death of which has been proclaimed by the crabbed, depressed, minimalist, dyspeptic human haters and anti-technology zealots who tell us that we are merely a cancerous blight on the earth. (Some of these folks, like the misanthropic Norwegian philosopher and founder of deep ecology, Arne Naess, yearn for a new virus to wipe out the horrible curse of man.)

People need to get into space for a multitude of reasons. But we will never get there without free markets to implement the technology we already have and bring to fruition the equipment to satisfy this widespread human desire. Regulation thwarts innovation by making creativity a crime, and by punishing businesses that would otherwise be successful enough to attract the necessary venture capital.

## The NASA Bureaucracy

Harry Stine offers an insider's lucid discussion of the scandalous way in which the federal government and NASA have throttled a rich vein of creativity through the bureaucratic "empire-building" of regulation, subterfuge, political back-stabbing, lying, and logrolling.

According to Stine, a group of Douglas engineers noticed that NASA's way of handling the problem of lofting payloads into space was fixed at the mentality of 1940s-style rocket artillery: the multistage booster and payload capsule. Imagine how far commercial aviation would have come, thought these few engineers at Douglas, if an airliner required a Cecil B. De Mille cast of thousands to prepare six months in advance for every trip from New York to Paris. Passengers would have to be trained for the ride weeks in advance, garbed in special, expensive tailor-made suits. When the day of the trip arrived, the vehicle would launch and proceed to jettison 95 percent of its parts, dropping these hideously expensive components into the ocean, never to be used again. And finally, arriving in Paris, the return flight would require another six months to replace the missing components, perform a major overhaul of the remains, and to engage in the same extravagant process of preparation with the same cast of thousands.

This small group of Douglas engineers embarked on an unofficial program, funded with shoestring capital that they raised almost entirely by their own efforts. By the late 1980s, they had produced and flown the first proof-of-concept prototype that would ultimately be a fully reusable single-stage-to-orbit (SSTO) vehicle able to deliver satellites and other payloads to low earth orbit (LEO) with the reliability and ease of airliners plying the sky between New York and Paris.

Despite smaller budgets than in the glory days of the moon program, in the late 1980s the space agency was still a bureaucratic, empire-building institution, quick to lunge at any threat to its health. To some of NASA's bureaucrats, the Douglas DC-X project appeared to threaten its turf. At the very least, its success was an embarrassment to NASA owing to the contrast between its tiny budget and the bloated financing of the space agency's projects. By offering Douglas money to fund the project, NASA succeeded in the time-tested ruse of hijacking it for itself. The agency turned it into another massive government program by divvying up the carcass among its many aerospace contractors (including, not incidentally, the corporate remains of McDonnell Douglas itself, now that this company had been taken over by rival Boeing).

NASA has a new, improved version of the SSTO vehicle and, a decade after the first (and to date, last) flights of the DC-X, has spent years running studies of all the various matters involved. It estimates a first flight of its spacecraft far in the future, following still more years of studies and tests.

## Another Blow to State Dogma

One frequently hears that the development of aerospace vehicles is a textbook example of the kind of capital-intensive venture at which private industry could never exhibit

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either the foresight or wherewithal to succeed. It is said that only the wise, all-knowing government can selflessly surmount the tawdry motive of short-term profit to focus on expensive, long-term, noble projects.

This perennial claim by freedom's enemies recently received another blow. A recent article in *Flight International* magazine reports that the Rotary Rocket Company has raised $17 million from investors and hired Barclays Capital to help it raise another $20 million in private funds in order to offer by the year 2000 commercial launches of satellites or other payloads weighing 3,200 kilograms to low earth orbit for a cost of $7 million, or $2,200 per kilogram. This is much less than today's going rate. To put this in perspective, compare the cost of launching John Glenn back into orbit, a recent publicity stunt by the attention-starved space agency: something on the order of $500 million—for a single mission.

Rotary's goal is "to herald the arrival of a new space age—the age of routine, commercial space transportation" by operating a fleet of aerospace craft called "Roton," which will be the world's first successful reusable commercial SSTO vehicle. The two-pilot Roton booster will be 20 meters high and 6.7 meters in diameter. The name of the Redwood Shores, California, company refers to the rotary pumping action of the Roton's Rocketjet engine and its free-spinning helicopter-style blades that deploy during the last phase of descent, enabling precise control for landing.

Scaled Composites is producing sections of the Roton's fuel tank. This company was founded by Burt Rutan, the designer of many highly creative aircraft, including the very popular home-builts Vari-Ese and Vari-Viggin, and the prototype of the twin-turboprop Beechcraft Starship, which may be the most advanced turboprop corporate airplane in production today. All of these aircraft use composite materials and an unusual tail-first "canard" configuration. Rutan also designed the privately created Voyager aircraft that was the first airplane to fly around the world without refueling.

Gary Hudson, Rotary's chief executive, says that Roton will begin deployments and retrievals of LEO telecommunications satellites and other cargo during the first half of 2000.

Other missions for the Roton include solar power satellites and space manufacturing of new materials. Because it is piloted, a Roton will be able to conduct a final check of satellites before their release, a service never offered before. While other commercial launchers charge clients a non-refundable advanced payment, Rotary Rocket's bill will be due only on successful delivery of the payload into orbit; any problems would result in returning the payload and launching it again with no further charge.

Rotons will also repair or retrieve damaged or "dead" satellites, which should lower insurance costs.

The Roton may well be the first profitable spacecraft. It is the product of imagination and funding that are entirely private and cost a tiny fraction of the time and money spent by its government-led competition.

Who says only the government can succeed with big, time-consuming, capital intensive projects?

Freedom is the great engine that draws out the breathtaking creativity of our human potential, because only freedom unleashes every person's desire to achieve happiness. In a free market, such achievement is advanced when we offer goods or services that please our customers, wherever they may be found on—or off—the planet. □

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THE FREEMAN
Ideas On Liberty

# The Great Bequest

by Tom G. Palmer

Limited government is one of the greatest accomplishments of humanity. It is imperfectly enjoyed by only a portion of the human race, and, where it is enjoyed, its tenure is ever precarious. The experience of the twentieth century is surely witness to the insecurity of constitutional government and to the need for both courage in achieving it and vigilance in maintaining it.

Advocates of limited government are not anti-government per se, as some people would charge. Rather, they are hostile to concentrations of coercive power and to the arbitrary use of power against right. With a deep appreciation for the lessons of history and the dangers of unconstrained government, they are for constitutional limitations: government should have the delegated authority and means to protect our rights, but not be so powerful as to destroy or negate them.

The American system was established to provide limited government. The independent existence of the United States was based on certain truths:

> that all Men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty, and the Pursuit of Happiness—That to secure these Rights, Governments are instituted among Men, deriving their just Powers from the Consent of the Governed, that whenever any Form of Government becomes destructive of these Ends, it is the Right of the People to alter or to abolish it, and to institute new Government, laying its Foundation on such Principles, and organizing its Powers in such Form, as to them shall seem most likely to effect their Safety and Happiness.

On this foundation the American Founders established a system of government based on delegated, enumerated, and thus limited powers.

The American Founders did not pluck these truths out of thin air, nor did they simply invent the principles of American government. They drew from their knowledge of thousands of years of human history, during which many peoples struggled for liberty and limited government. There were both defeats and victories along the way. The results were distilled in the founding documents of the American experiment in limited government: the Declaration of Independence, the Articles of Confederation, the state constitutions, and the Constitution of the United States.

## Students of History

The American Founders were careful students of history. It was Thomas Jefferson, in his influential *A Summary View of the Rights of British America*, prepared in 1774, who noted that "history has informed us that bod-

*Tom Palmer is director of the Project for a Civil Society at the Cato Institute. This article is adapted from the* Cato Handbook for Congress.



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ies of men as well as individuals are susceptible of the spirit of tyranny." Another Founder, Patrick Henry, devoted great attention to the study of history. He summed up the importance of history thus: "I have but one lamp by which my feet are guided, and that is the lamp of experience. I know of no way of judging the future but by the past." History—the lamp of experience—is indispensable to understanding and defending the liberty of the individual under constitutionally limited, representative government.

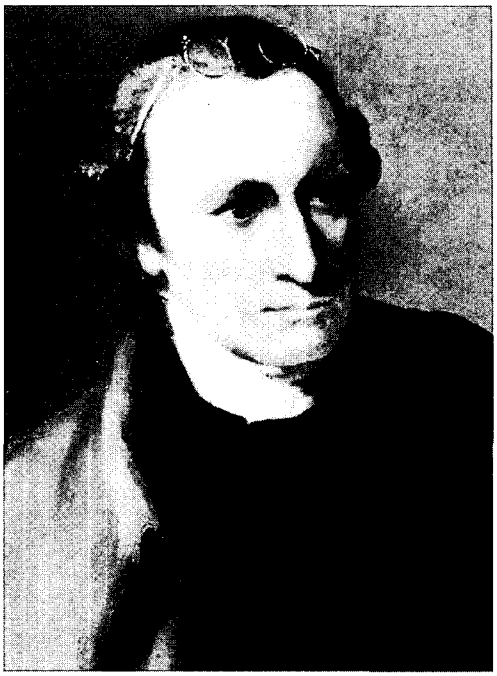
Through the study of history the Americans learned about the division of power among judicial, legislative, and executive branches; about federalism; about checks and balances among divided powers; about redress and representation; and about the right of resistance, made effective by the legal right to bear arms, an ancient right of free persons. Liberty and limited government were not invented in 1776; they were reaffirmed and strengthened. The American Revolution set the stage for the benefits of liberty and limited government to be extended to all. As John Figgis, professor of modern history at Cambridge University, noted at the turn of the century:

> The sonorous phrases of the Declaration of Independence . . . are not an original discovery, they are the heirs of all the ages, the depository of the emotions and the thoughts of seventy generations of culture.

The roots of the history of limited government stretch far back, to the establishment of the principle of the higher law by the ancient Hebrews and by the Greek philosophers. The story of the Golden Calf in the Book of Exodus and the investigations of nature by Aristotle both established—in very different ways—the principle of the higher law. Law is not merely an expression of will or power; it is based on transcendent principles. The legislator is as bound by law as is the subject or citizen; no one is above the law.

Many strands have been entwined to form the fabric of liberty:

• The struggle between church and state, which was put into high gear in the Latin West by Pope Gregory IV in the eleventh century under the motto, "freedom of the church." This movement, which created an institutional distinction between the church and the secular authorities, was the first major "privatization" of a previously state-owned industry (the church) and provided the foundation for such important institutions as the rule of law and legal accountability, federalism, and the independent and self-governing associations that make up civil society.



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*Patrick Henry (1736–1799)*

• The growth of civil society in the self-governing chartered towns of Europe, in which the guiding principle was "city air makes one free." The independent cities of Europe were the seedbeds of modern civil society—of the market economy, of personal liberty, and of the security of person and property.

• The fixing of limits on the powers of monarchs and executives through written constitutions. The Magna Carta of 1215 is the most memorable of those documents to inheritors of the Anglo-Saxon political tradition. It included the requirement that taxes could not be imposed without the consent of the "general council of the realm," which provided the

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origin of the English parliament, as well as other specific limitations on the king's power, including the stipulations that no one be imprisoned, outlawed, or exiled, or his estate seized, "except by the lawful judgment of his peers or the law of the land" and that "merchants shall have safe conduct in and out of England." This was the precursor of the Petition of Right of 1628, the Bill of Rights of 1689, the American Declaration of Independence, and the American Constitution and Bill of Rights.

Those various movements reinforced each other in a multitude of ways. The assertion of the freedom of the church and even of its supremacy over the secular powers was bound up with the idea of the higher law, by which all are judged—emperor, pope, and peasant alike. As legal scholar Henry Bracton, a judge during the reign of Henry III, noted of the royal authority, "The law makes him king. Let the king therefore give to the law what the law gives to him, dominion and power; for there is no king where will, and not law, bears rule." Were the king to consider himself above the law, it was the job of the king's council—the precursor of parliament—to rein him in: "if the king were without a bridle, that is, the law, they ought to put a bridle upon him." Not only was the nascent parliament above the king; the law was above the parliament, as Sir Edward Coke noted in the seventeenth century:

> when an act of Parliament is against common right and reason, or repugnant, or impossible to be performed, the common law will controul it, and adjudge such Act to be void.

## Law Supreme

The supremacy of the law over the exercise of power is a hallmark of the Western legal tradition. The rule of law is not satisfied by merely formal or ceremonial exercises, such as the publication of edicts in barely understandable form, whether in the archaic "Law French" of the king's courts or the pages of the *Federal Register*; the laws must be understandable and actually capable of being followed.

There was also widespread recognition of the principle of reciprocity between the holders of power and the general populace. Rights were spelled out in contractual form in constitutions and charters. Those rights were not gifts from the powerful, which could be taken away on a whim, but something on which one could take a stand. Tied up in the notion of a chartered right was the ancillary right to defend that right, even to the point of resistance with force of arms. The higher law, reciprocity and mutuality of obligations, written charters of rights, the right to be consulted on policy and to grant or refuse one's consent, and the right of resistance in defense of those rights are the foundations of constitutionally limited government. They were won over many centuries at great sacrifice.

Just how precious this heritage is can be gleaned from comparing it with the history of Russia, where, until very recently, there was no reciprocity between rulers and ruled, no independent power able to challenge the rulers. The principality of Muscovy and its successors were despotic to a high degree, with no charters of liberty, no power higher than the Tsar (or his successor, the Communist Party), no limits on power—in effect, no law. As Harvard University historian Richard Pipes noted in his book *Russia under the Old Regime*, "There is no evidence in medieval Russia of mutual obligations binding prince and his servitor, and, therefore, also nothing resembling legal and moral 'rights' of subjects, and little need for law and courts." The immense difficulties in establishing the rule of law, a system of well-defined and legally secure property, and a market economy are testimony to the great and vital importance of building on a tradition of stable, constitutionally limited government. They also remind us how important it is for us to maintain our heritage of limited government and the rule of law.

## Liberty Versus Power

The struggle for limited government was a struggle of liberty against power. The

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demands for religious liberty and the protection of property were fused in the heroic resistance of the Netherlands to the Empire of Spain in their great revolt. The Dutch became a shining example of what was possible when people were free: prosperity was possible without the guiding hand of the king and his bureaucrats; social harmony was possible without enforced religious conformity; law and government were possible without an unlimited and absolute sovereign. The Dutch inspired the English to rise up against the Stuart kings, who sought to fasten upon the English the absolutism that had made such headway on the Continent. The American Revolution was one link in a long chain of revolutions for liberty.

The story of the attempts to institute absolutism in the Netherlands and in England was well known by the American Founders, who were, after all, British colonists. One cannot understand the American attempt to institute limited representative government without understanding the history of England. What they were struggling against was the principle that the powers of the state are "plenary," that they fill up the whole space of power. King James I of England (then King James VI of Scotland) had written in 1598 that "the King is above the law, as both the author and giver of strength thereto." In 1610 James made *A Speech to the Lords and Commons of the Parliament at White-Hall* in which he railed against the notions of popular consent and the rule of law and stated that "as to dispute what God may do is blasphemy . . . so it is sedition in subjects to dispute what a king may do in the height of his power."

In other words, there are no limits to power. Distinct echoes of that view are still heard today. For example, the solicitor general of the United States, Drew Days, arguing in the case of *United States v. Lopez* before the Supreme Court, was unable to identify a single act of Congress, other than those expressly prohibited by the Constitution, that would be impermissible under the administration's expansive view of the Commerce Clause. Solicitor Days contended that the powers of Congress are plenary, that is, unlimited, unless, perhaps, specifically prohibited.

That all-too-common view turns the notion of limited government on its head. Limited government means that government is limited both to the exercise of its delegated powers and in the means it can employ, which must be both "necessary and proper." The English Revolution of 1640, the Glorious Revolution of 1688, and the American Revolution of 1776 were fought precisely to combat unlimited government. What Americans need is not unlimited government, as Days proposes, but limited government under law, exercising delegated and enumerated powers. That is how the equal liberties of citizens are protected. As the philosopher John Locke, himself an active participant in the struggles for limited government in Britain and the primary inspiration of the American revolutionaries, argued in his *Second Treatise of Government*: "*the end of Law* is not to abolish or restrain, but *to preserve and enlarge Freedom*: For in all the states of created beings capable of Laws, where *there is no Law, there is no Freedom*. For *Liberty* is to be free from restraint and violence from others, which cannot be, where there is no Law."

## Unprecedented Liberty

The American experiment in limited government generated a degree of liberty and prosperity that was virtually unimaginable only a few centuries before. That experiment revealed flaws, of course, none of which was more striking and repugnant than the toleration of slavery, or "man-stealing," as it was called by its libertarian opponents, for it deprived an individual of his property in his own person. That particular evil was eliminated by the Thirteenth Amendment to the Constitution, showing the self-correcting nature and basic resilience of the American constitutional system, which could survive such a cataclysm as the Civil War.

Other flaws, however, have been revealed or have surfaced since. Among them are the following:

• An erosion of the basic principles of federalism, as the federal government has consistently encroached on the authority of the

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**March 1999**

# Brutes in Suits

Statists on the left habitually congratulate themselves on their humanity. They croon on endlessly about peace, harmony, cooperation, community, mutual understanding, tolerance, and diversity. They profess to abhor violence and cruelty. They apparently regard candlelight vigils—featuring dozens of people swaying in unison and singing about love—as the most transcendent form of self-entertainment.

Statists on the right don't get teary-eyed at the mention of "peace" or "diversity," and most are as likely to attend a candlelight vigil as Bill Bennett is to model fashions by Dennis Rodman. But statists on the right nevertheless profess a high regard for peace and a hatred of violence.

But while their *particular* goals may differ, all statists are hypocrites. Their distinguishing mark (whether they realize it or not) is that they all advocate government-as-thuggery. Statists, whether on the left or on the right, advocate that government unleash its coercive powers in various and sundry ways, most of which would be criminal if done by private people.

The thugs in question happen to dress well, are well-coifed, and are (usually) articulate. But what makes someone a thug is not how he looks or what he proclaims to be his ultimate motive, but, rather, what he does. And most of what politicians now do is sophisticated thuggery. They're brutes in suits who sell to the highest bidders their willingness to coerce innocent people.

Here's an imperfect, but useful, way to test whether or not some government activity is thuggery. Ask: Is the activity one that ordinary people could ethically do on their own, either individually or in a group, in the absence of government? If the answer is yes, the government activity isn't thuggery. If the answer is no, the government activity is thuggery.

Consider, for example, a police officer directing traffic. This activity is legitimate; it isn't thuggery. It's legitimate because there is nothing inherently unethical about a private citizen directing traffic on a busy street. The same is true for government efforts to nab murders, rapists, thieves, and arsonists. Depending on your view of government, you might or might not trust government to perform these tasks effectively. You might also believe that even these tasks are best left to the private sector, or, instead, you might believe that it's prudent to assign these tasks to government exclusively. Either way, none of these tasks would be considered criminal or illegitimate if carried out by private persons in the absence of government. (Even legitimate activities arguably become ille-

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gitimate if they are funded through coercive means, such as taxation by government. No private citizen can ethically confiscate resources from others even if these resources will be used in ways that nearly everyone approves. Recognizing that I am skipping blithely over a fundamentally important issue, I ignore here the problems created by taxation.)

Regrettably, the overwhelming bulk of what government actually does today—even apart from using taxation to fund its efforts—would be (correctly) considered criminal if private persons did these things.

Examples are legion. Here's one: minimum-wage legislation. Suppose your neighbor offers to hire at $3.00 per hour someone to work in his supermarket. Would it be moral for you to stick a gun to your neighbor's head and order him not to hire anyone for less than $5.15 per hour? Of course not. Would it be moral for you to round up several of your friends into a mob and threaten to lynch your neighbor if he insists on hiring workers for less than $5.15 per hour? Of course not.

So what makes it legitimate for government to threaten people with violence if they insist on hiring workers at less than the government-stipulated minimum wage? Nothing. Nothing at all.

Consider other activities currently pursued by government. Would it be morally acceptable for the president of Bethlehem Steel to stand on the wharves in Seattle and threaten to shoot anyone who dares to unload steel made in Asia? Obviously not. It follows that import restrictions are immoral; only thugs promote and implement them.

Would it be morally acceptable for you to burgle your wealthy neighbors' home and then give the funds to a poor family living across the tracks? Obviously not. It follows that government's efforts to redistribute wealth are illegitimate.

Would it be morally acceptable for you to imprison your neighbor and confiscate her property if she refuses to install a wheelchair ramp at her place of business?

Would it be morally acceptable for you to storm into your neighbors' house and tote them off to a jail in your garage if you find that in the privacy of their own home your neighbors smoke marijuana or Cuban cigars?

Would it be morally acceptable for you to inflict violence on Americans who refuse to obey your command that they not hire Mexican or Filipino workers?

None of these activities enjoys any legitimacy when pursued privately. Indeed, they are all considered criminal.

So why should government be allowed to do these things?

Most statists respond by intoning that democratic governments carry out the will of the people. If it's the will of the people that, say, no worker be paid less than $5.15 per hour, then the few selfish reprobates who would violate the collective will should be prevented from doing so.

Numerous problems afflict this response, not least of which is the fact that democratic government *at best* carries out only the will of the majority. One of the most pernicious myths that today plague the popular political mind is that the appetite of some mysterious phantom called "the will of the people" is justly satisfied if as few as 50% of voters plus one acquiesce in schemes concocted by a cabal of politicians who are beholden to special-interest groups.

Sadly, the very logic of modern politics is that politicians and bureaucrats use the coercive powers of the state to transfer wealth from politically unorganized groups (for example, sugar consumers) to politically powerful groups (for example, sugar producers). But whether the state is coercing the minority to bow to the will of the majority, or coercing the majority to bow to the will of politically potent interest groups, such coercion is wrong—and it gains not a smidgen of legitimacy when carried out by telegenic talking heads who work in marble-domed buildings and are dressed by Armani.

Beware of brutes in suits.

Donald J. Boudreaux
*President*

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# The March of History

What comes to mind when you think about the month of March? For many people it is the ominous-sounding "Ides of March," the day when Brutus slew the dictator Caesar, announcing as he committed the act, "Sic semper tyrannus"—"Thus always to tyrants." In recognition of the connection between March, history, and the state, we are putting four of our most interesting history titles on sale. These books will help bring new worlds to life for you—something Caesar could have used!

**Leviathan at War**, Edmund Opitz, ed.

Published in 1995, this anthology addresses a number of war-related topics, including the causes of war, conscription, weapons and prosperity, war and liberty, and peace and free trade. This collection contains work by Leonard Read (including his important "Conscience on the Battlefield"), Ayn Rand, Ludwig von Mises (on the economics of war], military historian B.H. Liddell Hart, and Mark Twain, among others. One of our best *Freeman Classics*, this book provides an excellent foundation for arguing against the aggressive militarism so many governments adopt.

195 pages, paper $9.95 **SALE: $4.00**

**Capitalism and the Historians**, F.A. Hayek, ed.*

How often do you hear that the Industrial Revolution was a disaster for workers? Many historians argue the Industrial Revolution caused wage rates and standards of living to plummet; that the movement away from farms and villages toward cities and factories was a truly dreadful development. This small book debunks these myths and provides evidence that the Industrial Revolution caused standards of living to rise, which in turn, led to a vastly improved quality of life. A great antidote to the leftist diatribes one often encounters when reading about the 19th century.

191 pages, paper $12.95 **SALE: $6.00**

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More good stuff on the Industrial Revolution – one of mankind's **true** "great leaps forward." Dr. Burt Folsom brings together 22 essays that investigate the economic theories that undergirded the Industrial Revolution, the consequences of the Industrial Revolution, and the case for free trade. This book has been called "a veritable gold mine of facts about the history of free trade and of the free market." This 1996 work is great on its own or as a companion volume to Hayek's *Capitalism and the Historians*.

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**Theory and History,** Ludwig von Mises*

In his preface, Murray Rothbard says this book "provides the philosophical backstop and elaboration of the philosophy underlying *Human Action.*" This neglected work includes chapters on the Philosophy of History, the Concept of Historical Individuality, and the Meaning and Use of the Study of History. It is a powerful volume that illuminates Mises's earlier writings.

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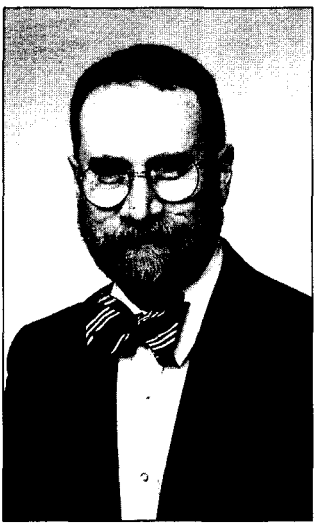
*An Evening with the Editor . . .*



## Sheldon Richman
# "Separating School and State"

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Sheldon Richman has given a new look and fresh editorial voice to *The Freeman.* He has recruited some of the world's top journalists and renowned free-market scholars to write for FEE's monthly magazine. And his own lively "Perspective" and "Peripatetics" columns are welcome additions to the editorial mix.

Sheldon is also an informative and entertaining speaker. Get to know him better at our April Roundtable. This informal gathering starts at 5 p.m. with a reception and dinner, followed by a spirited discussion on the perils of public education. Price is $35 per person.

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## Other Forthcoming Events at FEE

**Undergraduate Seminar, March 18-20**

**Trustees Annual Dinner, May 16**

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**Advanced Seminar, "The Economics and Ethics of the State," August 7-12**

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states. Federal criminalization of acts that are already criminalized by the states, for example, usurps state authority (as well as circumventing—opinions of the Supreme Court notwithstanding—the prohibition of double jeopardy in the Fifth Amendment to the Constitution). An even more striking contemporary example of the overreach of federal law is the continued exercise of federal controls over marijuana use in states—California and Arizona—that have legalized the medical use of that drug. The Tenth Amendment is quite explicit on this point: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

• Violation of the separation of powers between the various branches of government. In article I, section 8, for example, the Constitution explicitly reserves the power to declare war to the Congress, a power that the Congress has allowed to be usurped by the executive branch and which it should retake to itself. Further, the Congress has illegally exceeded its authority by delegating its legislative powers to administrative agencies of the executive branch, such as the Food and Drug Administration and the Federal Trade Commission. In addition to violating the Constitution, that has led to the erosion of the rule of law, as such administrative agencies have burdened the population with an unimaginably complex welter of edicts; the *Federal Register* runs to some 60,000 pages *per year*, representing a degree of minute regulation that is unreasonable and burdensome and that virtually guarantees that any citizen involved in a commercial transaction, for example, will run afoul of some part of it, no matter how well intentioned or scrupulous he may be. Such a situation is an invitation to the arbitrary exercise of power, rather than the application of law.

• Inattention to the important role of the federal judiciary as a check on arbitrary and unauthorized exercises of power. Especially since the threatened Court-packing "constitutional revolution of 1937," there has been too little attention by the federal judiciary—and by the Congress in ratifying judicial nominees—to fulfilling the role of the courts in enforcing constitutional restraints on both the federal and the state governments. For example, the Supreme Court has not consistently applied the prohibitions of the First Amendment to either commercial speech or political speech (the latter in the context of campaign finance), nor has the Court rectified the novel (and specious) distinction between personal liberties and economic liberties drawn by Justice Harlan F. Stone in *United States v. Carolene Products Co.* (1938).

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*Harlan F. Stone (1872–1946)*

• The failure to pass a constitutional amendment limiting members of the Senate to two terms and members of the House of Representatives to three terms. Just as the president is limited in the number of terms he can serve, so should be the other elected branch of government, to guarantee the rotation in office that the Founders believed essential to popular government.

## Needed Corrective

Those flaws can, however, be corrected. What is needed is the courage to place the health of the constitutional order and the

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future of the American system above short-term political gain. The original American Founders were willing "to mutually pledge to each other our Lives, our Fortunes, and our sacred Honor." Nothing even remotely approaching that would be necessary for today's members of Congress to renew and restore the American system of constitutionally limited government.

The challenge facing Americans today in defending constitutionally limited government was succinctly stated by the English libertarian Herbert Spencer in 1884:

> The function of Liberalism in the past was that of putting a limit to the powers of kings. The function of true Liberalism in the future will be that of putting a limit to the powers of Parliaments. □

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# Smoke Got in Their Eyes

Economics pervades life. Many people (not *Freeman* readers) will misinterpret that remark to mean that money is all that's important. And that common misinterpretation testifies to the dearth of economic education in America.

To say economics pervades life is the same as saying that choice pervades life. Everything we do volitionally requires that we choose one thing and forgo another. This is inescapable in a world where everything of value, including time, is limited.

We all understand this implicitly about our own actions. If you explain it to a child of, say, 10, he will know what you're talking about right away. He makes choices all the time.

But because economics, in this broad sense, is not taught early on to most children, and surely is not taught in schools and universities, people have a hard time applying it to most abstract matters, such as government policy. When they focus on that realm, suddenly there are no choices, and resources at any moment are limitless. Policymakers are the worst offenders.

No better example exists than the recent settlement between the tobacco companies and 46 state attorneys general. Economics was almost completely missing from the analysis of the settlement.

To recap, the tobacco companies, under the threat of pending liability suits and new government regulation, agreed to pay the states $206 billion over the next 25 years to "reimburse" them for medical expenses paid on behalf of residents with smoking-related illnesses. At first, state officials were licking their chops over what they will be able to do when the money starts rolling in. Now it is dawning on them that there might not be as much money as they thought.

The state of Arkansas is a case in point. "Is Windfall for State All Smoke, No Cigar?" asked a headline in the *Arkansas Democrat-Gazette*. The state was expecting a $20 million check from the tobacco companies by the end of 1998. But to pay that bill, the tobacco companies raised the price of cigarettes by 60 cents. The state's Department of Finance estimated that because of the price hike, cigarette sales would drop 11 percent, reducing tax revenues by $10 million in 1999. Easy come, easy go.

With the price increase comes an increase in the amount of tax smokers will pay on each pack, 2.8 cents to be exact. That led some people to believe that even if sales drop 11 percent, the state will still come out about $7 million ahead in tax revenues. Not so fast. Remember the broken-window fallacy.

At this point I must acknowledge, reluctantly, that Arkansas has a director of economic analysis and tax research who understands Bastiat's broken-window principle. "With people having to spend more for cigarettes, that money has to come from somewhere, so we look at that as a wash in sales tax," Joe LaFace said.

Good point. If smokers reduce other purchases to keep smoking as much as before,

*Sheldon Richman is editor of* The Freeman.



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they will simply shift from one taxed item to another. There won't be an increase in tax revenue.

Aside: That, of course, is a *good* thing. I never regard it as meritorious that a policy, even the repeal of a bad policy, produces more tax revenue. What's good about government's having even more money with which to commit mischief?

Well now. The windfall won't be as large as the states anticipated. And the reason is that the tobacco companies raised prices, presumably dampening demand for cigarettes. Surely no one is surprised that the tobacco companies will pay the states from money obtained from customers. Do the companies have some other source of money? Moreover, since smokers are disproportionately low-income people, we have the Alice-in-Wonderlandish spectacle of smokers' indirectly reimbursing the states for the medical services the state ostensibly pays for on their behalf.

To truly appreciate this, let's walk through it step by step. The states, through Medicaid, pay for the treatment of low-income people with smoking-related illnesses. The states demand that the tobacco companies, which made the product that produced the illnesses, pay the states the money spent on treating their customers. The tobacco companies raise their prices in order to have the money to pay to the states for the treatment.

Wouldn't it be more efficient—not to mention honest—to cut out the middle man? But doing so would give the game away. It would be equivalent to telling low-income people that smoking disqualifies them from Medicaid. How ominous would that be? The government would be announcing that personal habits will determine eligibility for government benefits. Precedent is powerful. If that policy is adopted for Medicaid, surely Medicare is next. And as the government slowly absorbs the medical industry (the attempted quick absorption came a cropper in 1993), it will have set the stage for the general denial of medical care on the basis of personal habits. Government will be in the triage business.

So, if you have clogged arteries and a life of ham and eggs behind you, perhaps Medicare won't pay for your coronary bypass operation. If you have a cyrrhotic liver and a boozy past, you might be turned down for treatment.

But that won't be the end of it. If you're an octogenarian needing a new hip, well, maybe those resources would be better devoted to a younger person with productive years still ahead.

That's the risk we run when we let government pay medical bills.

To cover all bases, we have to entertain the possibility that higher prices won't reduce the demand for cigarettes. There were early indications of that. We can't predict how people will act in the face of new alternatives. Let's assume demand falls not at all. What happens? As we've already seen, there will be no new revenue for the states. Furthermore, since smokers don't suddenly have additional income with which to pay the higher price, they will reduce other purchases. The falling demand for other products could result in cutbacks and layoffs in those industries. Let's assume all the people laid off are nonsmokers. That leaves us with an odd outcome. People who don't smoke will be made to suffer so that people who do smoke can have their medical expenses paid for. Not exactly justice, is it?

I think we can conclude that this tobacco deal is a fiasco. It's a mass of fallacy, confusion, and dishonesty.

But it didn't begin with the states' lawsuits. It's been going on for years. When the Clinton administration came in it spoke of raising the federal cigarette tax to, first, discourage smoking and, second, pay for health care and anti-smoking campaigns. Now I'm no Rhodes scholar, but isn't there a conflict between those two objectives? If you have plans for the revenue from the cigarette tax, you'd better hope people keep smoking. That would help save Social Security too.

They never learn. President Clinton wants the states to use their tobacco windfalls for anti-smoking programs. (Some states are resisting.)

I have an idea: the government shouldn't pay for *anyone's* medical care or tax our habits or lecture us on how to live. □

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THE FREEMAN
Ideas On Liberty

# The "Savings Crisis"

by John Hood

It's a constant refrain among politicians and the news media: America has a low savings rate. This, it is said, has dire consequences for the long-term health of the economy. Some analysts put the personal savings rate—the percentage of disposable income that isn't consumed in a given year—as low as 2.1 percent in 1997, a 63-year low. Although this undercounts the real amount of American savings and investment, there is no doubt that the private savings rate is near an all-time low.

Why is this? Are Americans simply irresponsible? Should government force households to save more money for a rainy day, as some doomsayers have suggested?

On the contrary. America's savings crisis is almost totally manufactured by government itself. Through punitive taxation and the growth of the welfare state, big government has legislated against the habits of thrift and delayed gratification on which human progress is based. The decline in the savings rate over the course of the twentieth century isn't just a minor economic trend. It represents the threat that government expansion poses to the principles on which successful human civilization rests.

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## What Is Savings?

It's worth pausing to consider the definition and origin of savings. After all, economists aren't talking simply about a bank account, or even an investment in stocks or bonds, when they address the issue of savings. For example, one's home is a form of savings, in that the value of the home usually appreciates even as one uses the home for current consumption (shelter).

Indeed, the official savings rates don't factor in the appreciating value of assets. They reflect the difference between reported income and reported expenditures. The Commerce Department, which generated the 2.1 percent rate cited above, doesn't actually track inflows and outflows of wealth. It doesn't include the rise in the value of investments in individual retirement accounts, 401(k) plans, real estate appreciation, or the rise in value of mutual funds or corporate stock. It doesn't count the implicit wealth people accumulate in pension plans. The Federal Reserve computes an alternative measure incorporating some of these factors and estimated that the 1997 savings rate was actually 7.1 percent of disposable income. Still, that's pretty small compared with the savings rates of other countries. In Asia, rates reach as high as 20 percent.

The reason the issue of savings is so impor-



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tant is that deferring consumption—which is probably the best definition of savings—is essential to human happiness. That statement may seem paradoxical. How can forgoing current pleasure or satisfaction by choosing not to buy a good or service today increase one's happiness? To answer that question, it's important to look at how four closely related economic behaviors—savings, insurance, investment, and specialization—arose among prehistoric human cultures.

## A Short Economic Prehistory

The earliest societies historians can identify are the nomadic hunter-gatherers who inhabited various regions of Africa, Asia, Europe, and the Americas. Throughout most of their history, these hunter-gatherers traveled in small groups of 20 to 30 related individuals—a patriarch and matriarch, their children and grandchildren, mates from neighboring groups, and other assorted relatives. They worked together both to hunt animals for meat and to gather fruits, vegetables, nuts, simple tools, and other useful objects. Because these groups were constantly on the move, their housing consisted of either portable shelters (tents, or yurts) or structures they found or could construct quickly (caves, lean-tos).

In this earliest of human societies, the line separating political, economic, and spiritual institutions was blurred or nonexistent. Few of the tools future civilizations would use to draw such lines were available to the hunter-gatherers. Their nomadic lifestyle, for example, provided little opportunity to develop or enforce private property rights, not only over land but over the products that land might produce. Private property rights are indispensable if societies are to separate the public from the private, the sphere of human activity over which political power is freely wielded and the sphere over which it is limited or excluded.

Furthermore, the small size of these societies necessarily reduced the extent to which differences in knowledge or talent resulted in the development of markets or a division of labor beyond the most rudimentary one. Finally, because they lacked any practical means of saving and transporting food of more than limited quantities, these earliest human societies provided little reward or incentive for hard work. All that was hunted or gathered was consumed relatively quickly. An individual who was exceptionally talented as a hunter or gatherer had no reason to invest much of his time performing those tasks.

## Stages of Economic Discovery

Even under these conditions, however, developments occurred in economic exchange and institutions. The earliest hunting and gathering humans cooperated with each other to derive sustenance from a sometimes-forbidding environment. They had to develop terms of trade and rules of work and reward in order to put members of the clan or band to productive use. A simple division of labor did evolve, based on age, sex, and physical prowess (or infirmity). We know that these small societies, while primitive and sometimes brutal, also gave opportunities for those with different natural talents and skills. And while the invention of money was far in the future, these early humans engaged in mutually beneficial trade in valuable goods that sometimes spanned surprising distances.

Archaeologists and anthropologists divide human prehistory before metallurgy into three periods: Paleolithic (Old Stone Age), Mesolithic (Middle Stone Age), and Neolithic (New Stone Age). The names suggest a categorization based on stone technology, but the real dividing lines among these periods involve changes in geography and corresponding changes in economic technology and organization.

For the purposes of understanding economic history, the Paleolithic Period is critical. It lasted from 2.5 million years ago until about 10,000 B.C. Humans during this period include Homo erectus and archaic Homo sapiens. Early in the period, humans used simple tools made either of the core of a stone after pieces had been flaked off, or the flakes themselves. They used fire (discovered sometime between 1 million and 500,000 years ago) to drive or prod animals, to prepare food, and of course to keep warm.

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Later, in the so-called Middle Paleolithic Period, flake tools were developed into a wide array of scrapers, borers, and points used to manipulate animal kills and other materials. This was the period of Neanderthal Homo sapiens in Europe and some humans even closer in appearance to modern humans. Their tools may have improved their hunting but, more important, there is evidence of extensive social cooperation not only in hunting but in storing and exchanging food. As one writer has noted, hunting is not just about killing animals. Killing animals is the easy part, whether it is by using weapons, by trapping, or by driving prey over cliffs. The difficult part lies in the organization of personnel so that they are in the right place at the right time and with the right gear to ensure a better-than-average chance of success.

Even more difficult is the task of coping with failure, weather, and the decline of animal stocks. Remember that these societies lacked effective technologies for storing food, and a diet of nuts, berries, and other gathered foods was of insufficient quantity or nutritional value to tide families and clans over in the event of a seasonal decline of game.

## Humans Beings Invent Savings

It is here, in the Middle Paleolithic populated by humans whose language skills were limited or nonexistent, that economic institutions extending beyond kinship probably developed. More specifically, these Middle Paleolithic people pioneered the crucial economic behavior of managing risk—in this case, the risk of starvation. They did it with two innovations: savings and group insurance. In the former case, they learned to put stores of food in secure places in their hunting and gathering territory, and then budget them to cover subsistence needs over the lean times. In the latter, nearby small kinship groups established social networks through alliance, intermarriage, visiting, and feasting that served as regional insurance policies. A group facing a decline in game (or lack of success in hunting) could make claims on the food stores of neighbors with whom they had previously invested time, attention, or their own food. This served to spread the risk of starvation over a broader number of hunters and gatherers, thus improving the chances of survival for all.

The concepts of savings and insurance are closely related; indeed, one might think of insurance as a way of realizing the benefits of savings without 1) having to develop technologies for saving food over a long period and 2) having to wait until a stock of savings is sufficiently large to tide a family or group over during hard times. Insurance-type arrangements, if they are of large enough breadth for their members to escape simultaneous misfortunes, represent a reasonable technique for coping with risk under difficult technological conditions.

The Upper Paleolithic, beginning about 50,000 years ago in various regions, represented the appearance of humans roughly identical to us today. It also brought two additional economic innovations of critical importance: specialization and investment. The Cro-Magnon and other advanced Homo sapiens of the Upper Paleolithic, unlike their predecessors, seem to have specialized in the hunting or gathering of specific species, rather than being purely opportunistic and pursuing whatever was visible in their range areas. Like savings and insurance, specialization was a form of risk management in the sense that it usually involved careful study of particular animals with the goal of predicting their behavior—and thus increasing the likelihood of catching them. Specialization took some of the risk out of hunting and gathering by allowing for the accumulation of knowledge with which small human societies could ensure a more stable and predictable food supply. It not only required study of animal habits and movements, but also a more detailed understanding of the climate and topography of their range areas.

Accumulating such knowledge had a cost. It took a great deal of time and effort, which earlier human societies had probably devoted to less taxing and more recreational activities. Indeed, many people assume that economic progress throughout history has meant a progressive increase in leisure time, but until recently the opposite has been true. In earlier Paleolithic groups, there was little to be

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gained by spending more time on hunting and gathering activities rather than on leisure activities. Hunting and gathering was such a hit or miss process that increased time and effort invested in it wouldn't have yielded much more in the way of results.

But with the introduction of specialization, increased time and effort devoted to the study of quarry and environment could pay off in higher returns. So the more sophisticated hunters and gatherers of the Upper Paleolithic discovered the value of investment—forgoing consumption or leisure in the short run for greater material benefit in the long run. Until it became practical to store information (through better language skills and specialization in a relatively narrow field of inquiry) investment would have had paltry returns.

This revolution in hunting and gathering had repercussions beyond improvements in the food supply. It was also associated with the development of larger, multi-family groups. For one thing, specialization and investment made population growth much more desirable. Additional people meant additional opportunities to gather useful information and carry out the more complex strategies required to catch more game. At the same time, the improved food supply made it possible to support larger populations. Specialization and the increased scale of human populations led to larger and more permanent settlements, and the beginnings of a territoriality that would eventually lead to concepts of private property. And both the larger populations and the increased productivity of hunting and gathering made possible a greater division of labor within the groups, allowing some individuals the option of specializing in tasks other than hunting and gathering.

## Savings and Investment Create Trade

Finally, the development of larger groups with a higher level of specialization created the conditions required to inaugurate trade among unrelated groups. After all, if one group chooses to specialize in a particular form of hunting and gathering, then the occasional acquisition of game or artifacts outside the specialty becomes more attractive. It represents variety and diversion. A coastal group specializing in catching fish and gathering shellfish would have something of value to offer an inland group specializing in hunting deer, horses, or other big game. This increased value of trade would apply not only to foodstuffs but also to other goods. In both western and central Europe of the Upper Paleolithic, for example, there is evidence that several species of seashells were traded or exchanged over hundreds of miles. Similarly, there is evidence of relatively long distance trade in high-quality flints and other raw materials.

The Upper Paleolithic Period ended with the end of the last Ice Age and the impact of global warming on the environment. The initial stages of this warming can be traced back to about 11,000 B.C., and affected different parts of the Old and New Worlds at different times. The oceans rose as ice melted, forests expanded over the expanses left behind by the retreating glaciers, and portions of the globe saw climate change of cold to temperate or temperate to hot. These changes led either to human migration or to significant changes in the way humans lived in their home areas. One further note about the end of the Upper Paleolithic is that it coincides with the final settlement of every habitable continent.

The key point for our purposes is that the development of multi-family societies, and later towns and cities, was based on the invention of economic practices involving delayed gratification, or savings. The habit of savings and investment paid its greatest returns once human settlements developed around new notions of private property. Once families could work their own land or tend their own herds, the economic value of hard work soared. After all, at a very basic level, agriculture and animal husbandry were the epitome of savings and investment. Rather than literally "eating the seed corn," farmers planted it in the ground, tended it for months (perhaps nearly starving the whole time), and then reaped a far greater bounty at harvest time. With herders, delaying gratification meant feeding scarce grains and water to stock animals rather than to their own families. It meant tending, not eating, the stock. Those

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who could learn to do this would, in the long run, be far better off that those hunter-gatherers who worried only about today's meal.

If one considers the broad sweep of human history, this radical revolution in how human beings live has occurred only recently. The passage of time from the last Ice Age and early human settlements to the modern day is, geologically speaking, a blink of the eye. Yet consider how radically different our lives are compared with our hunter-gatherer ancestors.

## The Savings-Rate Decline

Although no data exist on the personal savings rate per se throughout recorded history, one can safely say that it was extremely high. Even as recently as the nineteenth century, most Americans still lived and worked on farms. They spent most of their waking hours saving and investing—working the land for the promise of future return. Few could afford luxury items, vacations, or other forms of current consumption.

The Industrial Revolution changed all that. Mass production, first of clothes and later of other goods, significantly reduced their cost and thus reduced the amount of time and effort consumers had to save and invest in order to afford them. Advances in transportation technology came next, facilitating trade and thus the comparative advantages in price and quality of purchasing goods from others rather than making them oneself. Finally, dramatic advances in agricultural technology and practices so increased the productivity of farming that prices fell, far more food and fiber could be produced per person, and farmers gradually found their time and effort more profitably invested elsewhere.

The purpose of savings and investment changed from acquiring basic necessities to addressing "quality of life" goals. As workers moved to cities, then to suburbs, in the new industrial economy, savings and investment became a means of purchasing a new automobile, buying a nice home, sending children to college, affording higher levels of health care, dealing with sudden disability or unemployment, and providing for a comfortable retirement.

Unfortunately, the advent of the New Deal in the 1930s, followed by the Great Society programs of the 1960s, began to suggest to Americans that these big-ticket items in their lives might be paid for by someone else. Roosevelt's Social Security and unemployment insurance promised income in case of sudden loss of employment, disability, or old age. Johnson's Medicare and Medicaid promised families that they wouldn't have to save and invest to take care of elderly relatives who needed lots of medical attention or institutional care.

At the same time, these expansions of government spending required increasing amounts of revenue. The government got this revenue in large part by taxing private savings and investment. The first permanent income taxes arose in the early 1900s. Marginal rates soared during World War I and then rose again during the New Deal and World War II. Payroll taxes were added to fund entitlement programs, taking money that families would otherwise have saved for their own needs. Today, the income tax code is strongly biased in favor of current consumption and against long-term savings. For example, a worker who earns $1,000 will pay income and payroll taxes only once on that money if he chooses to spend it immediately. If he invests it in corporate stock, however, he will likely pay income tax on the money three or more additional times, as the corporation pays taxes on earnings, the worker pays taxes on his dividends, and then pays again if he leaves the investment to his heirs.

Is it any wonder that the rise of the welfare state has coincided with what many observers, of varying political persuasions, call a new ethic of instant gratification and self-indulgence? Public opinion polls show that Americans have become convinced that government will help them through the big expenses they will face in their lives, be it unemployment, education, health care, home-buying, disability, or retirement.

This is a mirage, of course. If one thinks of the money taxed out of families and "invested" by government for these future needs as the real rate of personal savings, then it's not being invested very well. Everyone knows the

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crisis that faces Social Security in the long run, as Baby Boomers retire and base their expectations of a comfortable old age on the prospect of government transfer payments from a smaller cohort of working Americans. But the problem isn't just limited to retirement. Medicare will go broke far earlier, perhaps in the next decade. Medicaid—increasingly a program of nursing-home payments for the middle-class elderly instead of an anti-poverty program—will collapse next. Unemployment insurance is already an awful deal for most workers, who are eligible to draw money only if they are terminated without cause, and even then they get paltry returns. The money Americans are forced to save and invest in education also gets poor returns, as the mediocre test scores of American schoolchildren and the declining academic standards of American universities illustrate.

So even if one defines the savings rate in the most expansive manner—as not only private savings but also the amount of money government "saves" on your behalf—there remains a savings crisis. Too little of our seed corn is being invested in long-term productive enterprise, with a promise of future harvests. Instead, government is feeding this seed corn to current beneficiaries of entitlement programs. Americans have lost the impulse that industrious human beings throughout history have maintained to work and save for the future.

This is the real savings crisis. It isn't just one of dollars and cents, but of thrift and self-reliance. The solutions are clear: end the tax code's bias against private savings and investment, and end government's false promise of saving and investing on our behalf. There is no more serious challenge facing American society and American freedom. □

*(For further background, see Barry Cunliffe,* The Oxford Illustrated Prehistory of Europe *(Oxford: Oxford University Press, 1994) and Mark Kishlansky,* Civilization in the West, Volume 1 *(New York: HarperCollins Publishers, 1991).*


# The Foundations of Morality

by Henry Hazlitt

In this impressive work Hazlitt explores the proper foundation of morality. It would give the game away to reveal his conclusion, but suffice it to say that Hazlitt conducts a detailed and scholarly inquiry into the many possibilities.

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THE FREEMAN
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# The Bully that Acts Like a Hero

by Harold B. Jones, Jr.

In 1995 President Clinton established what he called "Operation Restore Trust," a Health and Human Services initiative aimed at wiping out fraud and abuse in the health-care industry. According to the administration, only terrorism surpassed health-care fraud as a criminal problem in this country. The initiative relied on the False Claims Act, a piece of legislation dating back to the Civil War and designed to frighten Army contractors into honest billing practices by threatening them with a substantial fine plus triple damages for every false claim.

An Operation Restore Trust demonstration project in five states supposedly identified $23 in overpayments for every dollar spent on the project, and the program was expanded. Eighty percent of American hospitals and nearly 100 percent of those participating in Medicare were targeted for investigation.

The program used demand letters that began with a reference to the False Claims Act and went on to tell hospital administrators that "It has been determined that your institution should be civilly prosecuted pursuant to that act." A statement like that is a good attention-getter. It was, however, followed at a short distance by these words of comfort: "In order to expedite and simplify this matter, we are extending to all hospitals the opportunity to settle before litigation."

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One particular hospital received such a letter on November 21, 1996. The letter stated that in the 85-month period ending on December 31, 1994, the hospital had submitted 13,726 Medicare claims for a total of $140,648,474. Of these, the government said 36 were "false claims." Of the amount that had been billed, $7,998 had been billed incorrectly. Under the terms of the False Claims Act, if the hospital had defended itself in court and lost, its penalty would have been $153,576.15, in addition, of course, to its legal expenses. It settled out of court for a fine of $12,257.

## Abuse or Error?

Let's look at this case a little more carefully. The total number of Medicare claims was 13,726. Thirty-six were supposedly false claims. That figures out to be a "false claims" rate of about one quarter of one percent. The false claim dollar amount was less than one percent of one percent. To state the matter precisely, we have here the case of a complex bureaucratic process that was accurate in 99.74 percent of the cases and for 99.99 percent of the dollars involved.

This raises some questions. The most obvious is about the government's characterization of the hospital's behavior as "fraud and abuse." Could it not be more appropriately described as a simple billing error? What does this say about the honesty of our government? On the one hand, it goes to a hospital with a demand



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that is probably better described as extortion than regulatory oversight. On the other, it goes to the American people with a deliberate mischaracterization of the way private institutions have conducted themselves. It acts like a bully. It represents itself as a hero.

The government's behavior in cases of this kind undoubtedly has something to do with the character of the current president, but it has even more to do with the fact that government is an organization. Organizations differ in many ways, but beneath that variety are certain common denominators of organizational behavior. Let's examine the government's regulatory activities in this light.

## The Real and the Palatable

The student of organizations soon learns that there are at least two explanations for everything an organization does: an explanation that sounds good and the real explanation. (There could be several of each kind.) We learn the first by looking at the organization's statements about its purposes. We learn about the second by studying its behavior.

In his wonderful book *The Death of Common Sense,* Philip Howard looks at issues through the eyes of an attorney. He gives examples of government's stated objectives (the reasons that sound good), notes its complete failure to attain these objectives, and concludes that government is ineffective. It can be argued, however, that although it seldom attains its stated objectives, government is massively effective in reaching its real objectives. These objectives are never articulated, but they do exist, and they have been identified in the behavior of every organization ever studied. They are in fact the driving force in the life of an organization, and government is, if anything, more effective than other organizations in reaching them.

Consider the Food and Drug Administration and the Environmental Protection Agency as Howard describes them. The FDA set out in 1962 to examine the possibly harmful effects of some 200 food-color additives. The task was supposed to take 30 months. It actually took 28 years. In 1972, the newly created EPA was assigned the task of examining 600 pesticides and determining which should be removed from the market because they were hazardous. The Insecticide, Fungicide and Rodenticide Act gave the agency three years to carry out this project. More than 25 years have passed since then, and for most of this time over a thousand EPA employees have been hard at work on it. They have come to conclusions on the safety of about 30 pesticides. The rest, including those with regard to which the data indicate a significant risk, remain on the market.

If we content ourselves with believing that the actual purposes of our government and its agencies are the same as their stated purposes, we will conclude simply that the FDA and the EPA are incredibly ineffective. Something needs to be done, we will say, and we will vote for the person who claims to have a plan for doing . . . well, *something.* If we want to understand what's happening, though, we must recognize that the actual purposes of an organization are not necessarily the same as its stated purposes.

## The Law of Self-Preservation

Every organization we know has sought to perpetuate its own existence. I won't say there are no exceptions to this rule. Now and again one encounters exceptions to almost everything. The case of the organization that voluntarily ceases to exist is approximately as frequent as the case of the happy, healthy, and well-adjusted man who decides to drive his car off a cliff. It is not logically impossible, but it is extremely rare.

One of the best guarantees for an organization's continued existence is a public perception that it is involved in something important. Even organizations with large endowments need public endorsement. This creates a strong incentive for organizations either to expand their missions or to draw them out. In spite of flowery statements about their purposes, organizations display mixed sentiments about actually completing whatever it is they are supposed to be doing.

The original purpose of the March of Dimes was the discovery of a cure for polio. Well, the cure was discovered. The March of

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Dimes should have disbanded. Its work was done. But you already know the rest of that story.

Spinoza said everything seeks to persist in its own being. When applied to government and its agencies, this helps to explain the existence of regulatory codes that Howard says are so complex as to guarantee noncompliance. The Occupational Health and Safety Administration has estimated that at least 80 percent of all workplaces are not in compliance with the law. The reason? It's simple. Not even the most conscientious businessperson has time to keep up with four thousand detailed regulations.

Howard suggests that we need to develop more general laws that can be interpreted according to the demands of the situation and then hold people accountable. In the long history of governments on this planet, however, there have been very few changes of that kind. Almost without exception, legal systems become more detailed and complex over time.

## Complexity Breeds Power

Complex legal systems increase a government's power over its citizens. The Resources Conservation and Recovery Act (known as "Rickra"), for example, requires every company that receives hazardous materials to keep track of them and eventually dispose of them. RCRA also requires a ledger showing exactly where each container is located on the premises. Federal environmental agents go into large companies that could not possibly maintain minute-to-minute paperwork on the exact location of thousands of barrels and threaten criminal indictments unless the companies pay large fines. Once again, the government's behavior is more like extortion than regulatory oversight. A complex rule has allowed a government agency to make unreasonable demands without fear of being challenged in the courts.

Organizations never represent themselves as striving for their own preservation, of course. They always appear to be seeking to advance the interests of outsiders. I don't suppose too many people would challenge me if I said that Minute Maid is infinitely more concerned about selling orange juice than about customers' health. But an ad campaign based on that truth wouldn't get very far. To succeed in advancing its own interests, an organization must represent itself as seeking to advance the interests of outsiders. (As we'll see, with private companies the two sets of interests coincide.)

This law of organizational behavior holds true across the wide spectrum of organizations and in no way depends on the personalities or ideologies of the individuals involved. Government always manifests this tendency. That has been evident in both Republican and Democratic administrations.

## Antitrust Law

A good example is antitrust legislation, whose ostensible purpose is to protect consumers from monopolies that operate to restrain trade and therefore to raise prices. An examination of how the laws have been used, however, may raise some doubt. If the stated and real purposes were the same, the laws would provide a clear description of prohibited behaviors. A businessperson could use them to determine what was legal and what was not. As Ayn Rand pointed out, though, the antitrust laws are designed and have been interpreted in a way such that one cannot know whether they have been violated until after the fact. Numerous students of business ethics have pointed to this problem as characteristic of the regulatory laws in general. They are like a powerful trap with a defective trigger mechanism. Several people step over it without harm. Then all of a sudden and for no apparent reason, it takes off someone's leg.

During the 1930s, Alcoa had become an aluminum monopoly in the sense of being the only producer in its industry. But it was not a monopoly that constituted a restraint of trade. It had kept the price of primary aluminum at a level compatible with the maximum expansion of its market. At that price, profits were possible only by means of cost-cutting efficiency.

Alcoa had not entered into collusive arrangements with any other producer or with any of its customers or suppliers. It had done

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nothing to dominate the aluminum industry or forcibly prevent the entry of new competitors. It had done nothing to violate the law. All it had done was attempt to maximize its profits in exactly the way that economic theory says they can be maximized, by setting its marginal revenues equal to its marginal costs. Other companies did not enter the market because at the going price it was not profitable to do so. If Alcoa had raised its prices, though, or if a cost-cutting technology had been discovered, competitors would have appeared almost immediately. Given the opportunities of a free market, innovation would have happened sooner or later.

Under the antitrust laws, a monopoly, as such, was not illegal. What was illegal was "the intent to monopolize." Under those laws, Alcoa should never have been found guilty unless there was evidence that it had tried to maintain an artificially high price by taking aggressive action to exclude competitors from the market. No such evidence was ever presented. Judge Learned Hand, however, in *United States v. Aluminum Company of America* (1945), argued that the mere fact of being so productive that competitors had no incentive to enter the market was in itself sufficient evidence of monopolistic activities. Alcoa was penalized, Ayn Rand said, not for breaking the law, but for being a well-run business. The net effect was a higher price for consumers.

Five years later, the Cellar-Kefauver Act would sprinkle holy water on this injustice by declaring that market share could be used as evidence of intent to monopolize. It was nothing but an after-the-fact justification of something that had already happened. Behavior of this kind is what the great organizational theorist Karl Weick has described as retrospective sense making. The federal government was in effect looking back at its previous actions and reinterpreting them in such a way as to make itself look good. Instead of correcting the injustice, legislators re-defined the situation in such a way as to make Judge Hand's decision seem reasonable. The legislation was not described in these terms, but that was its effect. It explained away the Alcoa case, set the Justice Department free to initiate more cases of the same kind, and provided justification for the expansion of the antitrust division through the hiring of more lawyers. The government said it was protecting the public. It was in fact expanding the area under its own control.

The laws of organizational behavior apply quite as much to businesses as to the government and its agencies. Businesses, too, offer both real reasons and reasons that sound good. Businesses, too, seek to advance their own interests and represent themselves as seeking to advance the interests of outsiders. Businesses, however, come with a safety device called competition. A business operates under the hard necessity of providing something of value to its customers because if it doesn't, they will find another place to spend their money. If Ford doesn't provide me with a good car in exchange for my dollars, there are plenty of other companies that will. Competition puts constraints on the degree to which the actual performance of a private enterprise can vary from its stated purpose.

Governments, as monopolies, do not operate under this constraint. The only thing that can constrain the behavior of a government is an informed and active citizenry.

We need to start looking at the difference between the government's stated purposes and what it actually does. It claims to be protecting us. What it is actually doing is gradually taking away our liberty. Businesses are easy targets. Ever since 1902, when Theodore Roosevelt initiated the trust-busting era with his attack on the Northern Securities Company, the government has portrayed private institutions as offenders and itself as the defender of the public interest. It does not take much thinking to see that this is a misrepresentation. We need to remember that the government's freedom to harass a business is the freedom also to harass the individual. Ayn Rand would remind us that when one citizen's rights can be legally violated, no one's rights are safe. □

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THE FREEMAN
Ideas On Liberty

# Philosophy 1 On 1

by James R. Otteson

It is no secret that classical liberalism receives little attention in American academic philosophy, and then generally only as a historical artifact. What one hears is something like this: "No serious philosopher today believes that people can get on without substantial, organized help from the government. The only issues are in what way the government should help and to what extent; the issue of *whether* the government should help can no longer be seriously entertained."

There are of course exceptions—Robert Nozick, David Schmidtz, and Eric Mack come to mind—but they are a decided minority and, in my experience at least, are often not considered to be within the philosophical mainstream. I have thus faced considerable difficulty convincing my colleagues that classical liberalism is worth thinking about at all, let alone worth careful examination. But a free society is worth the effort, and so I have explored many methods of opening the closed intellectual doors I have encountered, believing that if I can get others to think about classical liberalism for just a few minutes, I will find some place where it matches up with—or, if I am lucky, accounts for—a deep moral or political intuition they already have. When that happens, I have found that classical liberalism suddenly gains a footing as a position that has at least the possibility of plausibility. And that is a start.

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## Connecting to Intuition

In my experience arguments for classical liberalism rarely get off the ground unless they can first make this connection to intuition. Hence the method I have settled on for extending liberty's cause in my discipline of philosophy is one that, first, seizes on a few of the adversary's deeply held intuitions and then uses those intuitions as bases on which arguments can be built. I think three intuitions in particular combine to make an initial case for the free society that almost any person, regardless of his political position, will find formidable.

Here's how I propose going about it.

Begin by asking whether there is anything wrong with rape. Now of course such a question may well shock its hearer, but a shock is sometimes necessary to get people to think hard about a different way of looking at the world. Ask your adversary to answer the question seriously. So: yes, there is something wrong with rape. Well, what is it exactly? It does not suffice to say that rape is self-evidently wrong because it might not be self-evidently wrong to everyone. The rapist, for example, might not think so.

To bring the matter into sharper focus, ask this next: Is rape *always* wrong—or might there be occasions when it is acceptable? What if raping a person would lead to some greater good? For example, should we consider whether the rapist might not receive such a degree of pleasure from the rape that it effec-



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tively cancels out the pain and suffering the victim experiences? On that ground, then, should we judge each rape on a case-by-case basis, asking in each instance whether the act in question led to a net increase or decrease in welfare? This question is typically met with horror: *of course* rape is always wrong and of course its wrongness is not subject to any utilitarian calculation. It is wrong absolutely and simply so. The following suggestion will now seem quite apt and will almost always meet with approval: rape is wrong always and everywhere because a person's body is inviolable; a person has an absolute right to his (or her) body, and anyone who breaches that right is acting immorally regardless of his reasons. A person is, as it were, the *owner* of his own body, and as such he has absolute say over what gets done to it.

At this point the case for a free society has already begun to be built, though one's adversary probably does not see it. It is time to call up the second intuition, again by asking a question whose answer will seem obvious. Is there anything wrong with slavery? Well, what exactly? Again we must not allow "self-evidence" to justify our belief that slavery is wrong because many people evidently have believed and continue to believe that slavery is at least in some circumstances acceptable. Might slavery be wrong because it violates the dignity of the enslaved by treating him as a means to someone else's end? Might it be wrong because it dehumanizes the enslaved, treats him as if he were the moral equivalent of a pack animal?

Yes, that is it: slavery is wrong because it treats a man as if he were not a man; it fails to respect his inherent dignity, his inherent worth as a human being. But suppose that Congress—and congressmen, note, are popularly elected—passed legislation requiring the enslavement of some minority of the population. Suppose that to supply vital industries with much-needed cheap labor, the majority of us decided to enslave all, let us say, Irishmen. This would be democracy in action; the whole process would be strictly according to protocol in a democratic country. That would be acceptable, would it not?

Of course not! the reply will come. Slavery can never be justified, no matter how many people voted for it. And now one's adversary will believe what has already been said with almost unshakable conviction: slavery disrespects the inherent dignity in a human being and is therefore always wrong. A person may not in any way be used against his will for the sake of another person, and his sovereignty over his own life is immune from democratic (or any other) lawmaking.

## Is Theft Wrong?

Now the foundations of the free society are almost entirely laid. Only one more element is required. Is there anything wrong with stealing? This matter can be a bit tricky, because there will be those who think that stealing is justified in the case of a poor man stealing from a rich man. Put that possibility off for a moment and ask the hearer to answer whether theft as a general practice is acceptable. Is it all right for anyone who wants something simply to take it regardless of who owns the thing in question? To this question the answer will be "no." But once again, why is it not all right?

Although the intuition that stealing is wrong is strong, people are often not quite sure what to say about why it is wrong. Proceed, then, with this question. Suppose Congress took a vote, and the majority, which carried the day, passed legislation licensing local police authorities to take anyone's property whenever in their judgment, and in their judgment alone, they saw fit to do so. Would there be anything wrong with that? Would the fact that such a practice had been signed into law thereby make the practice morally acceptable? Odds are that the answer to this will be "no" as well.

Make, then, this suggestion. People have a right to what they own—that is, to what they have legitimately acquired (through labor, trade, or gift); stealing violates that right and for that reason is wrong. To return to the case of the poor man stealing from the rich man: how wealthy a person is does not seem relevant to our explanation of why theft is wrong. Theft violates a right, and hence it is wrong regardless of whose right is in question. If one's

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adversary wavers on this point, remind him that there is always someone poorer than oneself, and thus everyone is a "rich man" relative to someone else—so if he is willing to allow an exception for a "poor man" to steal from a "rich man," he is effectively licensing not only everyone else but also himself to be robbed. Is he still willing to make this exception?

## Government Violates Rights

One can now move in for the coup de grâce: one's adversary, whether he realizes it or not, is a classical liberal. Everything the state does beyond protecting these basic, negative rights of individuals is a violation of these same rights. Conscription, for example, is a use of your body to which you did not assent. The income tax and the staggering national debt are nothing but obligations on you to labor for the benefit of someone else. Wealth transfers to the poor, subsidies to farmers, support for the arts, and Social Security are all the forcible seizure of some people's property in order to give it to others. And however noble the cause, however good the intentions, however many people voted in favor—rape, slavery, and theft are still wrong. And hence all the government programs that are merely particular instances of the principles underlying the immorality of rape, slavery, and theft are wrong as well.

One concrete example will show that the strong language of rape, slavery, and theft is justified in the case of government action. Estimated projections are that an average American born in 1999 will face an effective income tax rate of *one hundred percent* of his lifetime earnings simply to pay off the financial obligations that the American federal government will have incurred—and that is assuming that no more government programs are created. One hundred percent of lifetime earnings to make good on debts that these people played no part in creating and from which they will receive no benefit. How do you define slavery?

My genuine suspicion is that virtually all people are libertarians in their personal, everyday lives. In practice they regard anything that violates the sanctity of a person acting privately to be wrong. Certainly among my colleagues in philosophy I have met no one who would bodily assault another person (except perhaps in self-defense), who would enslave another person, or who would steal from another person. The challenge for the supporter of a free society, then, is threefold. First, he must get his adversaries to see that these three principles—the right to one's body, the right to one's labor, and the right to one's belongings—are the fundamental organizing principles of classical liberalism. Second, he must show his adversaries that they already subscribe to these principles, a fact demonstrated by their reaction to the series of questions raised above. And, finally, he must bring his adversaries to understand that these principles are binding on everyone, including those who work for the government.

This last point is especially difficult since many people are inclined to believe that the government has an authority all its own. That is, they think that if the government says something, it must be right; and if the government tells one to do something, one's sole duty is to obey. But one can summon a strong impulse to reconsider this thinking by pointing out that the government is nothing more than other people. If one would expect one's neighbors to live by the three principles of respecting others' lives, liberty, and property, then one should expect government employees to live by them as well. A person gains no special knowledge and earns no exemption from the requirements of morality merely by becoming an employee of the government.

Now I have not demonstrated that the free society is the only morally acceptable society (though I believe that it is). A philosophically sophisticated person will demand further argument for the principles underlying each of these intuitions, even if he shares them. It does not follow from the fact that one has a certain intuition about a moral matter, or even from the fact that many people have the same intuitions, that the matter is thereby settled. One's intuitions might after all be wrong.

Moreover, I have not yet shown that the moral principles that I have suggested underlie these intuitions are in fact the principles that underlie them. It is possible to construct

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moral condemnations of rape, slavery, and theft—and thus justifications for the respect of life, liberty, and property—without appeal to natural rights. It might be possible, for example, to give a utilitarian or consequentialist rationale for these principles, although the sense that these principles deserve absolute recognition will be difficult to preserve within a utilitarian moral framework. It is also quite possible that one either has these intuitions or embraces these principles because one subscribes to Austrian economic thought. A follower of Ludwig von Mises or F.A. Hayek may well adhere to the sanctity of these moral principles without thereby thinking that they are made sacred because of their reliance on natural rights. Mises himself thought that the notion of natural rights was an intellectual fiction. Or one might subscribe to these principles because one is a Christian who believes that each of us, as a child of God, is sacred. A follower of Father Robert Sirico will believe that it is a violation of God's will to treat another human being as anything other than inherently valuable and inviolable, and that one cannot fulfill one's Christian duty to others unless one is radically free to choose to do so. Or, finally, one might think that man's rational autonomy presupposes allegiance to certain universal rules, among which are the principles under consideration here. A Kantian will believe he is categorically commanded to treat others as ends in themselves and never merely as means, and he might for that reason believe that the free, classical liberal society is just the Kantian "kingdom of ends."

I would not presume to resolve here which of these foundations for believing in the principles of the free society, if any, is correct. But that is not my intent. My belief is that substantially all of us share the intuitions that suggest these principles, regardless of the specific set of background beliefs we hold that lead us to accept them. My purpose rather is to galvanize adherents to a wide array of beliefs to fight for the free society by showing them that anything beyond the minimal, libertarian state violates moral principles they already hold—*whatever* the basis on which they hold them.

## The Virtue of Consistency

All that would remain is to remind one's adversaries of the importance of consistency in applying these principles generally. The classical liberal society is not alien or extreme or licentious or bizarre or naïve. It is simply our own moral principles writ large; it is the manifestation and reflection of the person of dignity each of us believes himself to be.

Many years ago Hayek called on classical liberals to "make the building of a free society once more an intellectual adventure, a deed of courage" and to develop a program that would at once inspire us and serve as a blueprint for us to realize freedom under law. I think that such a program must begin by appealing to our deeply held intuitions, our pre-theoretical sense of right and wrong.

It is frequently remarked in America today that voters have a deep distrust for politicians and for politics; they are cynical about the whole political system, a fact that is regularly evinced by their exceedingly low interest in finding anything out about the people running for office. One will probably not understand this distrust and cynicism until one sees the constitutional, if perhaps unconscious, libertarianism that runs through many Americans. I suspect they distrust politicians and dislike politics because they are aware on some level that almost everything that goes on in politics is a violation of moral propriety. When the government bestows largess on them, they are by and large happy to receive it; but I suspect that most of them nevertheless harbor the perhaps vague sense that there is something wrong with this state of affairs.

Even if they think that they cannot but take advantage of the government's "free money" before someone else does, they would, if they were candid and forced themselves to reflect on the matter, admit that these are dishonorable actions. This, in part, is what stands behind Americans' general belief that politics is a sordid affair (and that politicians are little better than moral reprobates). What is required, then, is to bring into the open exactly what makes these actions sordid and dishonorable, and to discover explicitly the close connection between people's notions of

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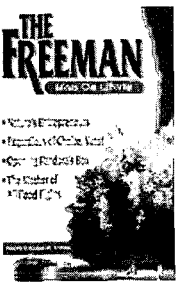
impropriety and the libertarian principles that give rise to them.

One way to begin this process of discovery is to get people who spend their time thinking about moral and political issues on a philosophical level—like philosophy professors—to begin to focus their mental energy on the philosophical underpinnings of the free society. The hope is that more and more of them will come to see the classical liberal conception of society as a compelling manifestation of some of their own fundamental moral beliefs, and, further, that they will then teach it to their students. In this way one might get people who are already prone to intellectual investigations to become intrigued with the strong intellectual appeal of the free society and to replace their perhaps present desire for a socialist utopia with a desire for a classical liberal utopia.

The free society *is* worth fighting for, and even a person in a tiny corner of human life—a person in academic philosophy, for example—can take up the cause of liberty and make a difference. The strategy I have outlined here can be an effective way to make people within academic philosophy open to the power of classical liberalism, but it can also, I believe, bear fruit with people outside philosophy. It can thus be a first step toward answering Hayek's call. I commend it to you. □


# The FREEMAN goes to high school!

Thousands of intellectually curious people, young and old, each year awaken to the world of ideas. Those whose "awakening" arrives in high school often participate in speech and debate. These young men and women deserve an opportunity to consider the great heritage of Western civilization and learn the role that private property, freedom of contract, and freedom of association have played in promoting prosperity and protecting Americans from arbitrary authority.




FEE's new Speech and Debate Program will make The Freeman, FEE books, and our redesigned web site valued resources for students. Our new newsletter, Freeman Notes on Speech and Debate, will be sent to over 5,000 high schools. Each monthly newsletter will promote The Freeman, encourage schools to subscribe, and feature excerpts from FEE books. FEE's publications and seminars will teach students how to apply these free-market and classical liberal concepts to speech and debate topics.

The 1999–2000 national high school debate topic will be "Resolved: That the federal government should establish an education policy to significantly increase academic achievement in secondary schools in the United States." FEE's Speech and Debate Program can play a vital role in countering statist notions, and proposing free-market reforms.

Please consider supporting this exciting new program. For further information, contact Gregory F. Rehmke, FEE's Director of Program Development (grehmke@fee.org).

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Economics

# Opportunities and Costs

My previous columns have been devoted to an overview of how markets work by facilitating social cooperation: providing people with the information and motivation to pursue their own advantages in ways that best create opportunities for others. My emphasis has been on the forest rather than the individual trees of economic understanding. Now I shall begin looking at some of the key concepts essential to applying economic reasoning to all human activity. I begin with opportunity cost.

## Limits and Opportunities

Economics has been called the dismal science because it studies the most fundamental of all problems, scarcity. Because of scarcity we all face the dismal reality that there are limits to what we can do. No matter how productive we become, we can never accomplish and enjoy as much as we would like. The only thing we can do without limit is desire more. Because of scarcity, every time we do one thing we necessarily have to forgo doing something else desirable. So there is an opportunity cost to everything we do, and that cost is expressed in terms of the most valuable alternative that is sacrificed.

But the pervasiveness of costs suggests that the dismal reality of limits is only one side of a coin with a brighter side. The limits of scarcity create costs only when there are opportunities. Eliminate the opportunity to choose among alternatives and there are no costs. If, for example, I am forced to live in a particular house, take a particular job, marry a particular woman, and consume a set bundle of goods, I incur no costs when I do those things. So the bright side of costs is the opportunities that create them. Expand our opportunities and the costs of everything we do increase.

Although we commonly see cost as something to avoid, in fact we are better off living in an economy where we are forced to confront the cost of everything we do. I personally might be better off if I could consume products without having to consider their costs because I could shift them to others. But any advantage I could realize would be more than offset if others could ignore the costs of their activities and shift them to me. As a result, we would all lack the information and motivation to choose wisely. Only when the costs of choices are imposed on those who make those choices can we best use the opportunities available.

This is one way of explaining the advantage of market prices. The prices people pay in the marketplace reflect the opportunity costs of their choices. You cannot generally purchase a good or service in a free market for less than others are willing to pay for it, or for less than the amount spent to make it available, which is an important part of the social cooperation that emerges out of market transactions.

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## Special Interests Don't Want Costs Considered

Unfortunately, many economic decisions are made not in a market setting in response to market prices, but by government in response to political considerations. This creates opportunities for the politically influential to acquire benefits paid for by the general public. Invariably, those seeking political benefits downplay the costs in the hope of justifying larger expenditures; they commonly argue that some things are so important that costs shouldn't even be considered.

Educators argue that education is too important to be considered in terms of costs; environmentalists argue that saving the earth is so imperative that environmental programs should be implemented regardless of the costs; recipients of medical research grants argue that human health trumps any crass consideration of costs; and people supported by the National Endowment for the Arts claim that the value of "art goes to the very soul of what it means to be human" and is "contaminated when compared with dollars and cents." (That's a close paraphrase of a statement on arts funding that I heard on National Public Radio.)

All these statements are best understood as attempts by organized groups to capture more public money. To consider costs has nothing to do with exaggerating the importance of money. Money provides a convenient way of expressing costs, but money is not the cost of anything. When I put down a ten-dollar bill to pay for a meal, the money may appear to be the cost, but the real cost is the opportunity cost—the subjective value I forgo by spending the money on the meal rather than spending it on the most valuable alternative.

## Silly Claims

To claim that we shouldn't consider the cost of doing some things is equivalent to claiming that we should do those things without considering the alternatives. That such a transparently silly claim continues to be used in special-interest pleading illustrates the power of deception over logic in political debate. Not considering the alternatives to doing something would make sense only if it were always more valuable than anything else. But this means that we should devote all of our resources to this one thing. If it were really true that fine orchestral music, for example, was so valuable that costs shouldn't be considered, then everyone should go homeless and hungry and spend all of their time listening to orchestras in the nude. This is obviously silly, but not one bit sillier than claiming that something is so important that it is inappropriate to consider its cost.

As soon as two or more groups claim that their program should be funded without considering costs, the relevance of costs should be obvious. Educating our youth and curing our sick cannot both be too important to consider cost, not in a world of scarcity. The cost of doing more to educate our youth is doing less to cure our sick, and vice versa. To ignore the cost of one is to treat the other as unworthy in comparison.

Of course, the reality of scarcity, and the opportunity costs that result, intrude into the political process despite the special-interest rhetoric disparaging considerations of cost. Comparisons have to be made among competing alternatives, so opportunity costs are considered in the political process. Unfortunately, imperfections and biases in the political process prevent the opportunity cost of government action from being adequately considered. The result is what one should expect when alternatives are poorly considered. Waste occurs as decisions direct resources out of more valuable and into less valuable activities, and often into activities counterproductive to the stated objectives.

Market prices do not perfectly reflect opportunity costs, but one can appreciate how close they get by considering the perversities that arise because political decisions often ignore most of the costs of a policy. I shall consider this problem next month as a way of further illustrating the importance of opportunity costs in understanding economics. □

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# CAPITAL LETTERS:

## Vive la Différence?

**To the Editor:**

In her articles on "individualist feminism," Wendy McElroy is offering merely a core-feminist approach in sheep's clothing, much like "equity" feminism and "equal opportunity" feminism, both of which single women out as androgynous integers needing vindication for centuries of "brutalization," "exclusion," "mistreatment," and so forth, none of which jibes with the truth. Our grandmothers were not that helpless! If one has not studied feminism, such nuances get lost in the shuffle.

The problem with all types of feminism is that men *and* women are on this earth together, and the trick is not to focus on one or the other as feminism does (and possibly libertarianism tends to do). It is necessary to seek a *common good* felicitous to the human race, as the Founders had in mind. McElroy's approach is too one-sided and thus inevitably futile. That there were brave and active women in the past should not require our apostheosizing them now when they've already been accorded their due in the melting pot of history (Nightingale, Barton, etc.).

Whether McElroy likes the idea or not, society is not founded on activist, adventurous, manly women but on *loving, nurturing, womanly wives, mothers, housewives, teachers of the young, and so forth*. As Midge Decter has put it, feminists are merely females who balk at adult womanhood, and the idea of "individualist feminism" comes dangerously close to Tocquevillian dysfunction.

In the end, the big problem for feminism is that good women rear strong sons, and a healthy, natural division of labor serves to foster strong male leaders. Thanks to "sex equality" and bans against "sex discrimination," we're not seeing male leadership anymore. Although I am not an Objectivist, I think Ayn Rand would agree with me on this: You can't have strong men and dominant women at the same time. "Strength" for each has a different frame of reference.

—W. EDWARD CHYNOWETH
Sanger, California

**Wendy McElroy responds:**

It is difficult for me to tell how deeply the two of us may disagree on the issue of feminism, as I simply do not hold the beliefs you ascribe to me. Individualist feminists routinely encounter an understandable problem in today's politically correct environment: namely, the "feminist" label overwhelms the word "individualist," when exactly the opposite is true. For example, as a feminist, I oppose both affirmative action and sexual harassment laws.

Rather than deal with particulars, however, let me clarify what I consider to be the theoretical foundation of individualist feminism. It is natural rights, based upon a Lockean model. Men and women have equal rights, which should be acknowledged in the same manner by law. This means neither oppression nor privilege. It does not mean equity in the sense of redistributing wealth or power; it means equality under a system that fully reflects the natural rights of both sexes. If such a system existed—embodying neither oppression nor privilege—I would cease to actively call myself a feminist. Unfortunately, government currently treats women differently from men. It generally assumes a protective role toward women, which I believe to be as damaging as an outright denial of rights. As long as the law accords different treatment to women and men, there will be a need to oppose that difference.

Whether women should choose to raise strong sons, as you suggest, is a personal choice every woman must make for herself. My personal lifestyle is rather traditional, but my political emphasis is on choice itself in the broad sense.

I, too, look forward to a day when there is no need to discuss men and women as though two legal categories. I hope to play a small part in bringing such a society about. □

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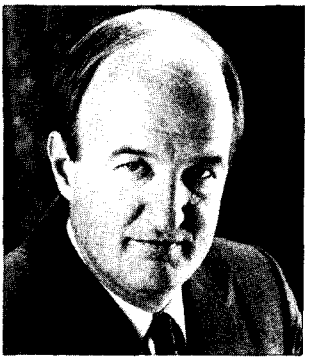
Ideas On Liberty
MARCH 1999



# Y2K and Entrepreneurial Error

"No businessman in the real world is equipped with perfect foresight; all make errors."

—Murray N. Rothbard[1]

Over the past year, I've been involved in a series of debates over the impact of the Year 2000 Problem, the potential collapse of computers—and perhaps of the economy—owing to the fact that since computer programs use two digits instead of four to indicate years, the year 2000 will be treated as 1900. On the one extreme is Gary North, who claims that the Y2K problem is so serious that it will gravely disrupt society for years. On the other end is Harry Browne, who says that enlightened entrepreneurs will avert a worldwide disaster.

What's interesting about the debate is that free-market advocates are found on both sides. North and other naysayers focus on the propensity of market players to make entrepreneurial errors and engage in shortsightedness. Browne and other optimists stress the entrepreneurs' ability to solve problems, especially when so much is at stake. (Some businesses could go bankrupt if they don't address the Y2K problem.) In short, the market works.

My concern is that the "market always works" camp comprises true believers who blindly think the market can solve all problems almost automatically. They seem to fit into the rational equilibrium-always school of economics where entrepreneurial misjudgment, imperfect knowledge, and uncertainty play little or no role.

## Markets Are Not Perfect

The Austrian economists teach otherwise. Israel Kirzner, noted for his studies on entrepreneurship, attacks the model of perfect efficiency as "wholly unsatisfying." He adds that "It is most embarrassing to have to grapple with the grossly inefficient world we know with economic tools that assume away the essence of the problem with which we wish to deal."[2]

The market is characterized by profit and loss, success and failure, certainty and uncertainty. There is always room for improvement, and the entrepreneur's role is to eliminate errors and inefficiencies. Thus, it should come as no surprise that many businesses and financial institutions are making significant headway in fixing their computer programs to avert the Y2K problem.

On the other hand, it would be folly to ignore that many businesses have budgeted insufficient time and money to fix or replace their computers. Evidence is growing that most firms, especially small businesses, are

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not doing enough. Many major corporations and government agencies, both here and abroad, admit that they only have time to fix critical systems. The rest will fail on January 1, 2000.

Free-market advocates sometimes place too much faith in the market's ability to solve problems and ignore ubiquitous error in an entrepreneurial economy. Think about all the ways people make mistakes every day in the marketplace: Investors buy the wrong stock. Businessmen declare bankruptcy. Marriages break up. Consumers over-spend and over-eat, especially during the holidays. Kids fail to do homework. Drivers have accidents. Ships sink. Builders don't meet deadlines. Economists make false predictions. Entrepreneurs cut corners, deceive customers, and embezzle funds. Economic failure, stupidity, and incompetence are common to human nature. As Ludwig von Mises noted, "To make mistakes in pursuing one's ends is a widespread human weakness."[3]

The decision by computer programmers in the early 1950s to use two digits instead of four is a classic example of individual shortsightedness. To save space, they cut corners, and now, a generation later, the whole world is paying a heavy price for their blunder.

## Cluster of Errors

In most cases, entrepreneurial error is random, unpredictable, and self-correcting. As Murray Rothbard stated, "As a rule only some businessmen suffer losses at any one time; the bulk either break even or earn profits."[4]

There are, however, cases of widespread error—mistakes that affect virtually every part of an industry or economy. Rothbard, in standard Austrian school fashion, explained depressions in terms of "a sudden general cluster of business errors."[5] Of course, the Austrians attribute those errors and the business cycle in general to monetary inflation by government.

Yet can't error with far-reaching harm occur in the market without government being responsible? Austrian economists don't normally discuss this possibility, but it undoubtedly exists. Market decision-makers have made shortsighted blunders that have had universal consequences. Examples of such error include asbestos in construction, pesticides in agriculture, and air and water pollution in manufacturing. The Y2K computer glitch is a particularly tough challenge because it is universal and time-sensitive. In most cases, the deadline cannot be postponed.

## The Market's Self-Correcting Mechanism

Fortunately, the market has a built-in mechanism to minimize mistakes and entrepreneurial error. The market penalizes mistakes and rewards correct behavior. Business leaders know that computer problems can destroy their business; fixing the Y2K bug will avoid losses and may even be profitable. They are willing to pay the price. As Kirzner has said, "Pure profit opportunities exist whenever error occurs."[6] At the same time, the market will severely penalize businesses that have ignored the Y2K problem or have procrastinated.

Followers of free markets should take note: markets may be self-correcting, but they are not all-seeing. □

1. Murray N. Rothbard, *Man, Economy and State* (Los Angeles: Nash Publishing, 1970), p. 746.
2. Israel M. Kirzner, "Economics and Error" in *Perception, Opportunity, and Profit* (Chicago: University of Chicago Press, 1979), p. 135.
3. Ludwig von Mises, *Theory and History* (New Haven: Yale University Press, 1957), p. 268. Mises adds that "Error, inefficiency, and failure must not be confused with irrationality. He who shoots wants, as a rule, to hit the mark. If he misses it, he is not 'irrational'; he is a poor marksman."
4. Murray N. Rothbard, *America's Great Depression*, 4th ed. (New York: Richardson & Snyder, 1983 [1963]), p. 16.
5. Ibid.
6. Kirzner, pp. 132–33.

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# BOOKS

**For Your Own Good: The Anti-Smoking Crusade and the Tyranny of Public Health**

by Jacob Sullum

The Free Press • 1998 • 288 pages • $25.00

Reviewed by John Attarian

Hounded by billboards and other "public-service" exhortations, barred from lighting up almost everywhere but in their own cars and homes, and saddled with rising cigarette taxes, smokers are being treated like pariahs—for their own good, of course. The anti-smoking crusade asserts that tobacco companies concealed the dangers and addictive nature of cigarettes, and manipulated their nicotine content to addict smokers; that all tobacco forms are bad; that secondhand smoke greatly endangers others; that people, especially impressionable teenagers, smoke because of insidious advertisements like Joe Camel; and so on.

In this levelheaded and well-informed book, *Reason* magazine senior editor Jacob Sullum convincingly debunks these claims. Smoking's health hazards have been known, and openly discussed, for decades. So has manufacturers' control of cigarettes' nicotine levels. Cigars and smokeless tobacco are far less dangerous than cigarettes. No evidence exists that casual exposure to secondhand smoke is a significant danger. As for supposedly sinister old Joe, the most important factors influencing teenagers' decisions to smoke are their sense of smoking's risks and benefits, the demonstration effect of family members who smoke, and peer behavior.

Opposition to smoking, Sullum points out, is nothing new. King James I, Pope Innocent X, and others denounced tobacco as addictive, unhealthy, inconsiderate of others, and downright wicked. But people kept smoking for the benefits and pleasures they got from it, and brushed off warnings of health hazards.

The 1964 Surgeon General's report stated that smoking, linked to cancer and other ailments, was a health hazard serious enough to warrant "appropriate remedial action." This opened, in Sullum's words, "the most concerted, sustained, and successful effort in history to discourage the use of tobacco." *For Your Own Good* carefully narrates that effort. At first, public health officials realistically recognized that Americans would not abruptly kick the habit, and opted to steer them to safer cigarettes with low tar and nicotine. But gradually the objective changed to eliminating all tobacco use. The anti-smoking movement won several victories. Cigarette advertising on television and radio was banned after 1970. Increasingly blunt warnings were mandated on cigarette packs and cartons.

Feeling the pressure and terrified of lawsuits, the tobacco companies responded by criticizing the evidence of health hazards as inconclusive, sponsoring its own research into the link between tobacco and lung cancer, and introducing filter-tipped and other "safer" cigarettes. Sullum observes that this refusal to acknowledge smoking's well-known dangers "has made the cigarette business the most reviled and distrusted industry in America." The unrelenting threat of lawsuits finally broke the tobacco companies' resistance, and in 1997, to limit their liability, they offered the (in)famous $368.5 billion agreement with the federal government.

Sullum acknowledges the cancer risk and describes nicotine as "the most dangerous recreational drug." He describes the tobacco companies as "cynically dancing around the truth to ward off liability and protect [their] profits," but he adds that they "didn't fool anyone who didn't want to be fooled."

By contrast, one of the anti-smoking movement's worst aspects is its end-justifies-the-means dishonesty, which Sullum abundantly presents: twisting research to fit its agenda, attacking researchers for saying what they in fact did not say (for example, that some cigarettes are safe), and relying on hysterical rhetoric, ad hominem assertions, and outright falsehoods. Sullum himself has been smeared as being "in the pay of the tobacco industry," because R.J. Reynolds used one of his articles

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in an ad campaign and a tiny fraction of the Reason Foundation's budget comes from Philip Morris contributions.

A favorite recent recourse of the smoking-bashers is cigarette tax increases. This will reduce smoking marginally, but will also spawn corruption and smuggling. Furthermore, stating that smoking is sensitive to price defeats the argument that cigarettes are irresistibly addictive. As Sullum wryly notes, "giving up cigarettes when the price of a pack goes up twenty-five cents is not the behavior of someone who is powerless over nicotine."

Indeed, addiction receives much attention. Sullum concludes that smoking is a habit difficult to break, but not impossible (America has about as many ex-smokers as smokers). Will power is crucial. Smoking bashers who assert that cigarettes are irresistibly addictive are in effect abolishing man as a moral agent; "they criticize individualism itself, because it implies that people are responsible for their own behavior."

Given the anti-smoking crusade's premises, a cigarette ban is its logical culmination. But Prohibition and the war on drugs, Sullum shows, provide a valuable cautionary tale of crime, corruption, and despotic encroachments on individual liberties.

*For Your Own Good* is a rare, welcome voice of reason and truth about cigarettes. If you want to make sense of the smoking war, don't miss it. □

*John Attarian is a freelance writer in Ann Arbor, Michigan, and an adjunct scholar with the Midland, Michigan-based Mackinac Center for Public Policy.*

**Star-Spangled Men:**
**America's Ten Worst Presidents**
by Nathan Miller
Scribner • 1998 • 272 pages • $23.00

Reviewed by Gene Healy

Historians who evaluate American presidents suffer from a bias against inaction. In the conventional view, great presidents are the nation builders and the war leaders; the failures are the ones who "never did anything."

Nathan Miller, author of *Star-Spangled Men: America's Ten Worst Presidents*, shares the conventional bias. For example, he indicts Silent Cal Coolidge with Mencken's faint praise: "He had no ideas, and was not a nuisance."

Those of us who favor limited government see it differently. This would have been a happier century by far if the worst that could be said of any president was, "He had no ideas, and was not a nuisance." One (unintended) virtue of Miller's book, then, is that it reminds us of some of the forgotten men who have held America's most powerful office, yet somehow managed to leave well enough alone.

Miller picks his losers by asking, "How badly did they damage the nation they were supposed to serve?" What's strange, then, is that the presidents he selects were mostly peacetime leaders who did little perceptible damage to the Republic and its institutions.

Take Coolidge, whom Miller writes off as "a reluctant refugee from the nineteenth century." Miller fairly sneers at Coolidge's emphasis on fiscal probity and laissez faire. Unable to find much to criticize in the uninterrupted prosperity of Coolidge's tenure, Miller tries a cheap shot: Coolidge's "penny-pinching refusal to cancel [the war] debts contributed to the rise of Adolf Hitler." Well, maybe. But as long as we're doling out responsibility for Nazi atrocities, why don't we give some to Woodrow Wilson? Wilson's dragging the United States into World War I allowed the Allies to impose a punitive peace on Germany in the first place. Why, then, does Miller consider Wilson a "near great" president?

Unlike Wilson, Coolidge was never awake for long enough to do much damage; as Miller recounts, he slept 11 hours a day. During his waking hours, Silent Cal's sound instincts allowed him to hew to the presidential equivalent of the Hippocratic Oath. As Coolidge put it, "Nine-tenths of a president's callers at the White House want something they ought not to have. If you keep dead still they will run out in three or four minutes."

Miller's chapter on William Howard Taft inspires reflection on the varieties of presi-

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dential obesity. Mencken saw Grover Cleveland's great bulk as indicating a kind of implacable strength. But Taft's girth reflected placidity and inaction, complementing his sedate view of the presidency: "the president cannot make clouds to rain, he cannot make the corn to grow, he cannot make business to be good." Miller rates Taft as the ninth worst, but his tenure in the White House was marked by peace and prosperity.

Warren G. Harding receives the most undeservedly rough treatment of any president examined. From a classical liberal perspective, Harding was arguably the greatest president of the twentieth century. He initiated the largest spending cut in history—a 40 percent reduction from Wilson's last peacetime budget. And Harding's good nature and liberal instincts led him to overrule his political advisers and pardon Socialist presidential candidate Eugene Debs. Debs had been jailed during Wilson's jihad against opponents of World War I, but Harding turned him and other dissenters loose; "I want [Debs] to eat his Christmas dinner with his wife," he said. The scandals surrounding Harding's administration push him near the top of Miller's hit list. But, as Miller notes, he never took "so much as a nickel" from any of his corrupt cronies.

Despite the author's depressingly conventional perspective on presidential greatness, *Star-Spangled Men* is tremendously enjoyable. Miller can turn a memorable phrase: (for example, he writes that Kissinger "looked like a Bronx Butcher and operated with the cynicism of a Renaissance Cardinal") and has an eye for the kind of detail that makes reading history fun.

Read with the proper attitude, *Star-Spangled Men* inspires reflection on what we should value in a president. □

*Gene Healy is a student at the University of Chicago Law School.*

**Fantasies of Salvation: Democracy, Nationalism, and Myth in Post-Communist Europe**

by Vladimir Tismaneanu

Princeton University Press • 1998 • 216 pages • $29.95

Reviewed by David L. Prychitko

Communism is dead, but collectivism is quite alive. Vladimir Tismaneanu's book *Fantasies of Salvation* explains why. Tismaneanu, once a Romanian dissident and now professor of government and politics at the University of Maryland, argues that while the centrally planned, socially engineered visions of Marxism-Leninism are dead, the false, utopian hope of emancipation through the state lives on. The myth of socialist internationalism has now been replaced by a new myth, populist nationalism.

Communism declared that its aim was the unification and collective freedom of workers around the world, but the new post-communist vision abandons that myth for a much narrower but equally deadly one. The new political vision in many former socialist regimes is not the Western ideal of individual freedom and civil society. Instead, "the nation" is the focus of attention.

The 1990s are a stubborn and sobering reminder that classical liberalism does not necessarily replace socialism by default. Although there have been success stories—countries like the Czech Republic, Poland, and Slovenia, for example—the 1990s might be better remembered for the Bosnian war, the growing Kosovo crisis, and the return of refugee camps. Who would have thought that the collapse of the Berlin Wall would be followed by the return of ethnic cleansing?

Tismaneanu shows that the problems of post-communism remain because the fight is less about the freedom of individuals and more about the emancipation of the ethnic enclave. Throughout eastern and central Europe "the nation" is paraded as the true center of history, the source of dignity, the subject of sorrow and oppression. The author

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demonstrates how this emergent populist-nationalism seeks to destroy individuality, pluralism, and democracy and instead champions unity, stability, and authoritarianism.

Tismaneanu's explanation of why collectivism has re-emerged in many post-communist states is worth quoting at length:

> The end of communism has left individuals with a sense of loss: even if they hated their cage, it offered at least the advantage of stability and predictability. Like former prisoners, they now have freedoms but do not know exactly what to do with them. Under these circumstances, they are ready to espouse the rhetoric of the tribe with its emphasis on group identity and community values. The neurosis of the transition period, the collective fear of a general collapse, the closing of the historical horizon and the anger at the new economic barons nourish sentiments of revolt, distress, and intolerance. There is need to find scapegoats, to identify those culpable for the ongoing sorrows. The political myth of lost and reconquered ethnic unity serves precisely this purpose: to explain defeats and alienation and reassure the individual that he or she has a place within the *volkisch* community.

In the face of all this, Tismaneanu remains optimistic over the prospects of the liberal intellectual dissidents in the post-communist countries and their continued resistance against collectivist nationalism. The emergence of classical liberal institutions—a market economy, a fully flourishing civil society, and constitutional democracy—remains critically dependent on them.

I highly recommend this book. Those familiar with Ludwig von Mises's *Nation, State, and Economy: Contributions to the Politics and History of Our Time* will find in Tismaneanu's book a fascinating and probing updating to *our* time. □

*David Prychitko studied the former Yugoslav system on a Fulbright grant in 1989, and currently heads the department of economics at Northern Michigan University in Marquette. He is co-editor, with Nevenka Čučković, of a collection of classic articles by Mises and Hayek, translated into Croatian.*

## Out of Order

by Max Boot

Basic Books • 1998 • 252 pages • $25.00

Reviewed by George C. Leef

Max Boot is a journalist and editor at the *Wall Street Journal* who has made a name for himself (and a lot of enemies) with his articles exposing the despicable practices of plaintiffs' lawyers who will do almost anything to squeeze money out of "deep pocket" defendants. With *Out of Order*, he turns his considerable writing and reportorial skills toward another facet of our legal system—judges. Once highly respected pillars of the community, the ranks of the black-robed contain, Boot argues, many who have little or no regard for justice. This is a serious problem that has received too little attention. Thus this is a welcome book.

The bad-judge problem has several facets. One that Boot addresses is partisan judges, ones who have an ingrained preference for certain litigants, lawyers, or causes, so that their courtrooms are about as fair as the Stalinist show trials of the 1930s. Plaintiffs' lawyers know who they are and naturally contrive to file suits in their courts. You have probably heard of the multimillion-dollar punitive damage awards in cases where there was truly no harm at all, such as the infamous repainted BMW case in Alabama. But how do these absurd instances of legal plunder ever get to trial at all?

The answer is that some judges—elected with copious amounts of money contributed by lawyers who will have cases before them—are unwilling to serve the interests of justice by dismissing suits that are transparently nothing more than legal extortion. Boot names names and gives the nasty details.

But the harm done by rogues who play favorites is minimal when compared to the harm done by another class of bad judges—those who have aided and abetted in the unconstitutional expansion of power of government. This has mainly been the work of the Supreme Court and the lower federal courts, many of whose members have been chosen

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for their philosophy that the Constitution's restraints on governmental power should be "interpreted" in such a way as to give the Congress and President virtual carte blanche. This category includes judges who insist on amending the Constitution through creative interpretations. As an example, Boot cites Justice Ruth Bader Ginsburg—long an advocate of the vague, never ratified "Equal Rights Amendment"—who managed to smuggle it into the Constitution with her opinion in the Virginia Military Institute case.

Yet another facet of the bad-judge problem is the phenomenon of judges who regard themselves as potentates, taking over prison systems, ordering busing schemes, and even decreeing that taxes be raised for their utopian visions. Consider, for example, the Kansas City judge who decided that he was going to "equalize" educational opportunity by ordering an incredibly costly program of inner-city school construction, or the New York judge who ordered the City of Yonkers to build hundreds of units of low-income housing in middle-class neighborhoods. Power always attracts authoritarians. That judges can get away with a lot of tyranny bodes ill for the future.

Given that we have a judicial system infested with judges who are partisan and judges who use their positions to coercively reshape society, what are we to do? Boot discusses several ideas for ameliorating the problem. He suggests, for example, ending the practice of popular election of judges, which has had the unfortunate effect of putting justice up for sale—read his account of a race for the West Virginia Supreme Court. That might help, but it might just as well turn out like so many other attempts to clean up the political system and merely hide the problem.

Assume that judges were chosen through some other political mechanism. The special interest groups that have been getting the judges they want through elections will not give up their quest merely because we enact some reform statute. They will simply concentrate their efforts on influencing the new judicial selection method, perhaps by getting friendly faces appointed to the judicial selection board. Under a "reformed" system, it may be even harder to identify judges who are puppets of organized labor or the plaintiffs' bar.

The bad-judge problem has the same roots as most of our other problems, which is to say, our over-politicized society. Trying to rein in partisan and Constitution-wrecking judges is, I fear, an exercise in futility as long as so many people see politics as a legitimate way of getting what they want.

But even if there is no easy remedy for the bad-judge problem, we still ought to be cognizant of it. *Out of Order* skillfully assists us. □

*George Leef is book review editor of* The Freeman.

## A History of the American People

by Paul Johnson

HarperCollins Publishers • 1998 • xv + 1,088 pages • $35.00

Reviewed by Burton Folsom

"The creation of the United States of America is the greatest of all human adventures. No other national story has such tremendous lessons, for the American people and for the rest of mankind." So begins Paul Johnson in his upbeat and first-rate *A History of the American People*.

As a British historian and non-academic, Johnson avoids the pitfalls of so many American historians. Academic historians in particular often impose a double straitjacket on U.S. history: first, that economic issues have been paramount in shaping American politics; and second, that government intervention in the American economy has been necessary and benign. Johnson disputes both of these points.

Johnson gives due attention to economic issues, but he also highlights the crucial role of religion in shaping American history. For example, he takes the Puritans seriously as men of ideas. Later, he analyzes the Great Awakening, the religious fervor of the 1740s. "The Great Awakening," Johnson argues, "was thus the proto-revolutionary event, the formative moment in American history, preceding the political drive for independence

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and making it possible." George Whitefield, its leader, "was the first 'American' public figure, equally well known from Georgia to New Hampshire."

In Johnson's history, the rise of America to world prominence is a fascinating story, full of key inventions and daring entrepreneurs. Liberty, not government, is what extended the American dream to millions of Americans, immigrants and natives alike, during the 1800s.

The 1900s might well be called the century of big government in U.S. history. "It was [President Woodrow] Wilson who first introduced America to big, benevolent government," Johnson asserts. But Wilson "was corrupted by power, and the more he had of it the deeper the corruption bit, like acid in his soul."

Johnson prefers Calvin Coolidge: "No one in the 20th century defined more elegantly the limitations of government and the need for individual endeavor, which necessarily involves inequalities, to advance human happiness." Coolidge cut taxes, promoted free enterprise, and had the lowest misery index (inflation plus unemployment) of any president in this century. "Of those who came to power at the same time as Coolidge, all the most notable were dedicated to expanding the role of the state."

When the Great Depression hit, both Hoover and Roosevelt brought bigger government to America—and much of it had negative consequences, according to Johnson. "No series of events in modern history is surrounded by more mythology than the New Deal," Johnson writes. "There was no actual economic policy behind the program." Democratic Presidents Kennedy and Johnson and Republican Nixon expanded government further. But, Johnson says, Ronald Reagan, a "conservative revolutionary," challenged the Democratic hegemony. Johnson curiously ignores Nixon's failed economic intervention, but praises him for challenging the Kennedy money and the "liberal" media.

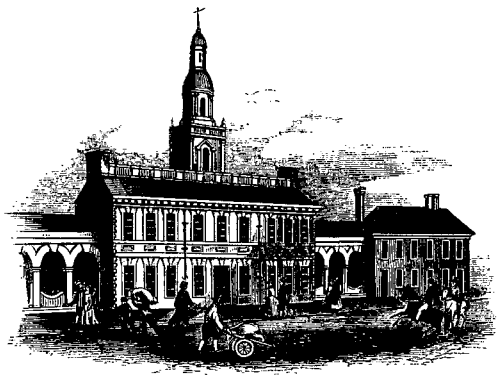
Johnson's history is a superlative achievement, not only for his knowledge and insights but also because he is an able writer and captivating storyteller. In a recent interview, Johnson showed impatience with historians who "niggle" at his work, but more niggling by his editors would have cleared up a variety of misspellings and minor errors. Zachary Taylor was a Whig, not a Democrat; it's Alfred Sloan, not "Sloane," and John W. Davis, not "Davies." But let me niggle no more.

Critics accuse Johnson of being biased, but he is in fact balanced and nuanced in his treatment of historical events and personalities. Johnson *appears* biased to other historians because so many of them are accustomed to teaching from the standard "liberal" texts that dominate the market—for example, Samuel Eliot Morison's *Oxford History of the American People.*

Where Johnson treats Coolidge with respect, Morison lashes out, calling him "a mean, thin-lipped little man, a respectable mediocrity . . . dour, abstemious, and unimaginative." Where Johnson dissects the New Deal, Morison is filled with gushing praise, saying that it was "just what the term implied—a new deal of old cards, no longer stacked against the common man. . . . Probably it saved the capitalist system in the United States."

These snippets are typical of the "history" most Americans have learned. Johnson's excellent work often stands in opposition to the conventional wisdom. It deserves a wide readership among students as well as adults, and if so, we may yet train our next generation to appreciate American history. □

*Burton Folsom is senior fellow at the Mackinac Center for Public Policy. He is author of* The Myth of the Robber Barons *and* Empire Builders.



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Economics

# Illuminating the Unseen

The good effects of laws are often easily seen. The bad effects, unseen. So observed Frederic Bastiat 150 years ago. His basic insight remains true today. We live in busy times. Information bombards us. In such a world, even that which is seen is often overlooked. The unseen is that much more elusive.

If we are to make the case for economic freedom, we have to bring these unseen costs to light. Consider an increase in the minimum wage. What is seen: businesses give some of their low-wage workers a raise. The direct effects of the minimum wage—more money for low-wage workers, less money for businesses that pay them—frame the entire debate. Senator Christopher Bond of Missouri says the minimum wage is bad because it hurts small business—as he argued in his recent re-election campaign. So most people see the minimum wage as a tax on small business that helps the poor. No wonder many people think it's a good idea.

If we want to dent the consciousness of the average American, we have to talk about how the minimum wage doesn't just tax small business. We have to show how it bankrupts some firms that hire low-skill workers. That means fewer opportunities for low-skill workers. But even the firms that survive will try to reduce the hours of low-skill workers and their numbers. In short, while the minimum wage helps some low-skill workers by giving them a modest pay increase, it has a devastating effect on others, pushing them out of the work force and into the street. The minimum wage thwarts human possibility among those it tries to help. And as Bastiat understood, it is easy to see those who are helped by the minimum wage. Those who are harmed are much harder to identify.

We've done a decent job explaining the hidden costs of the minimum wage. We've done such a good job, in fact, that proponents of the minimum wage have actually tried to argue that increases in the minimum wage have *no effect* on low-skill employment. To paraphrase Orwell, you'd have to be an academic economist to find that argument compelling. But in other areas, we have a long way to go if we wish to cast light on the unseen costs of government intervention.

## Free Trade and Protectionism

Here's how trade often gets discussed in the media: should we destroy jobs in America in order to have cheap imports? That's like being asked how long you've been beating your wife. Why does it get discussed this way?

Opponents of free trade want the American people to think that trade is about destroying jobs in order to get cheap foreign goods. It makes free trade look mean-spirited and mercenary. But another reason is that these are the most obvious effects of free trade. If Americans buy from foreign suppliers, people

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understand that fewer Americans will be hired in the competing domestic companies. Unseen are the jobs created to make the products we exchange with foreigners. Unseen is the impact of specialization and comparative advantage. Unseen is the power of foreign competition to induce our domestic industries to innovate.

Unless we can illuminate the unseen, making the case for free trade will be an uphill battle. Unfortunately, one of the best things about free trade is extremely difficult to see: free trade allows resources to flow to their highest use. But to make the argument compelling, we have to describe it in a way that allows it to be seen without a semester's worth of economics.

## Freeing Up Opportunity

Somewhere in South Carolina, there's a high school girl whose mom works in a textile factory. This girl doesn't know what she wants to do with her life, but like most high school kids in America, she probably doesn't want to work in the same job or career as her parents. The security of the textile factory is appealing, but she might want to go to college and try something different. It all depends on her options.

That factory is threatened by Chinese competition. Should we let the factory go under or should we protect it from the cheaper Chinese imports? We could spend hours on the pros and cons and the economic impact of that decision. But let's look at the impact on that girl in high school. If we keep the factory around, we make the choice of working in the factory more appealing. If we let the factory die, we change the available options. We push her out into the world.

Exploring the world is a good thing, but that's not reason enough for letting the factory go under. What is harder to see is that the world to be explored is a more vibrant and alive place when the factory goes under. Allowing the factory to die frees up capital and management skill that can be used elsewhere. If we maintain all of the factories and all of the companies that cannot survive competition, then the American economy is a much more static place.

If we try to make everything for ourselves and be self-sufficient, we lose the opportunity to specialize in doing what we do best. Our capital gets tied up in industries that do not take the greatest advantage of our unique skills. Free trade allows a high school kid in South Carolina to inherit a world of maximum human potential, with the maximum chance for her to use her gifts, whatever they may be.

A skeptic would ask how the girl in South Carolina is going to achieve her potential if her mom is out of work. And that in turn might lead to a discussion of how past generations have managed to survive and thrive in a dynamic economy. In 1900, one-third of the American work force was in agriculture. Today the number is around 3 percent. Do you think the kids on the farms of 1900 are glad that we let agriculture become more capital intensive with fewer jobs? It wasn't a trivial transition, but in 1900, we couldn't see the industries that would arise to use the skills of the next generation. And we can't know the opportunities that will arise to help that girl in South Carolina if we let the textile factory fail. But they will arise. What they will be depends on the gifts and aspirations of the next generation.

If we want to inspire people to support free trade, we must touch their imagination. Bastiat understood that 150 years ago. Our best chance is to make the unseen, seen. Economics can bring the unseen to light, but only if we leave the jargon behind and show how free trade and other economic freedoms help transform our lives. □

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*What passing-bells for these who die as cattle?*
*Only the monstrous anger of the guns.*
*Only the stuttering rifles' rapid rattle*
*Can patter out their hasty orisons.*

WILFRED OWEN (1893–1918),
from "Anthem for Doomed Youth"

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